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No. _____

In The

Supreme Court of the United States

October Term, 1995

NORTHERN STATES POWER COMPANY,
a Minnesota corporation, and
NORTHERN STATES POWER COMPANY,
a Wisconsin corporation,

Petitioners,

vs.

UNITED STATES OF AMERICA,

Respondent.

Petition For Writ Of Certiorari
To The United States Court Of Appeals
For The Eighth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether Congress, in creating the system under which taxpayers are charged higher rates of interest on sums that they owe to the IRS than they earn on sums that the IRS owes to them, has granted the IRS unfettered discretion to charge taxpayers who are net creditors of the government interest at the higher rates, even though such taxpayers would owe no such interest if the IRS followed Congress' direction to computationally "net" the taxpayers' overpayments against their underpayments;

2. Whether the Court of Appeals, in seeking the "plain meaning" of the Internal Revenue Code and the Tax Reform Act of 1986, erred in summarily disregarding the intent of Congress, as repeatedly expressed in the legislative history, that the IRS must computationally net taxpayers' overpayments against their underpayments to prevent the unfair prejudice which would otherwise result from treating taxpayers who had overpaid their aggregate tax obligations as if they had underpaid them;

3. Whether the Court of Appeals correctly held that the right of taxpayers to computational interest netting is controlled solely by the IRS' discretionary debt collection powers under § 6402(a) of the Code, thereby rendering the interest netting provisions in § 6601(f) of the Code and § 1511(b) of the Tax Reform Act of 1986 meaningless; and

4. Whether the Court of Appeals' decision is in conflict with the decision of the Seventh Circuit embracing netting principles in *Pettibone Corp. v. U.S.*, 34 F.3d 536 (7th Cir. 1994).

LIST OF PARTIES

The parties involved are Northern States Power Company, a Minnesota corporation, ("NSP-Minnesota"), Northern States Power Company, a Wisconsin corporation ("NSP-Wisconsin"), and the United States of America. NSP-Minnesota is the parent corporation of an affiliated group of entities that filed consolidated federal income tax returns for the years in question. NSP-Wisconsin is a wholly-owned subsidiary of NSP-Minnesota and a member of the affiliated group on whose behalf the consolidated tax returns were filed. All of NSP-Minnesota's other first-tier subsidiaries are also wholly-owned, although several corporations owned by one of those subsidiaries, NRG Energy, Inc., are not themselves wholly-owned. For its part, NSP-Wisconsin owns less than all of the shares of one of its subsidiaries, Chippewa & Flambeau Improvement Company. This petition is brought by NSP-Minnesota and NSP-Wisconsin which are referred to collectively below as "NSP."

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NSP commenced the present tax refund suit against the government in 1992 seeking refunds of its 1980 through 1984 income tax liabilities. In 1994, the government agreed that the IRS had in 1990 grossly overassessed NSP for those five tax years and agreed to repay more than $29 million to NSP. However, in computing the amount of interest owed to NSP, the government refused to "net" or credit NSP's overpayments of its 1981 and 1982 taxes against NSP's underpayments of its 1980, 1983 and 1984 taxes during the time when these overpayments and underpayments had existed simultaneously. The government refused to do so even though the sum of NSP's overpayments had at all times exceeded the sum of its underpayments. By refusing to "net" NSP's overpayments and underpayments, the government sought to charge NSP at the higher interest rate applicable to underpayments, while separately refunding to NSP interest at the lower rate applicable to overpayments. Because the parties could not agree on this netting question involving some $460,000 of disputed interest, it was the sole issue litigated.

On November 18, 1994, the United States District Court for the District of Minnesota granted NSP's motion for summary judgment, holding that the government was obligated to compute the interest owed to NSP by netting NSP's overpayments against its underpayments. (App. 15.) A written order was entered on November 22, 1994, (App. 22), and judgment was entered on December 6, 1994. (App. 24.)

The government appealed to the United States Court of Appeals for the Eighth Circuit, and on January 2, 1996, the Eighth Circuit reversed the district court. *Northern States Power Co. v. U.S.*, 73 F.3d 764 (8th Cir. 1996). (App. 1.) NSP petitioned for a rehearing with a suggestion for rehearing en banc. On February 22, 1996, the Eighth Circuit directed the government to file a response, and on April 5, 1996 denied the petition. (App. 23.)

JURISDICTION

Petitioners seek review of the January 2, 1996 decision of the Eighth Circuit Court of Appeals. (App.1.) Petitioners' request for rehearing with a suggestion for rehearing en banc was denied on April 5, 1996. (App. 23.) Jurisdiction to review the decision of the Eighth Circuit in this civil case by writ of certiorari exists under 28 U.S.C. §§ 1254(1) and 2101(c), in compliance with Rule 12 of the Rules of the Supreme Court of the United States.

STATUTES INVOLVED

Statutes applicable to the case include: the Internal Revenue Code of 1986 including 26 U.S.C. §§ 6402(a), 6601(f), and 6621; sections 1511(a) and 1511(b) of the Tax Reform Act of 1986, P.L. 99-514, 100 Stat. 2085; section 11341 of the Omnibus Budget Reconciliation Act of 1990, P.L. 101-508, 104 Stat. 1388; and section 713 of the Uruguay Round Agreements Act, P.L. 103-465, 108 Stat. 4807. The texts of the statutes are set forth in the Appendix. (App. 26.)

STATEMENT OF THE CASE

In 1990, following its examination and audit of NSP's returns for tax years 1980 through 1984, the IRS disallowed certain deductions claimed by NSP in those years and assessed additional taxes and interest against NSP in the aggregate amount of $23,630,893. NSP promptly paid the assessed amounts, exhausted all required administrative remedies, and commenced the present suit for refund under 28 U.S.C. § 1346(a)(1) in the United States District Court for the District of Minnesota.

In October, 1993, NSP made a settlement offer to the government. After ten months of internal review, the government accepted the offer, as amended, in August 1994. The settlement established: (1) the correct amount of NSP's original tax liabilities for each of the five tax

years in question; and (2) the extent to which the government's $23.6 million of additional assessments made in 1990 had been improper and excessive. In particular, the agreement established that: (1) NSP had substantially overpaid its 1981 and 1982 tax obligations, but had underpaid its 1980, 1983 and 1984 tax obligations (although the sum of NSP's overpayments had at all times exceeded its underpayments); and that (2) NSP's payment in 1990 of the $23.6 million of assessments had increased NSP's status as a net creditor of the government by that amount. Thus, the government agreed to repay NSP over $29 million in tax and interest.

However, NSP and the government were unable to agree upon the correct method for computing the amounts of interest which the IRS was required to pay to NSP. The government took the position that even though NSP's overpayments for 1981 and 1982 had at all times exceeded its underpayments for the other three years, and NSP therefore had always been a net creditor of the government, the government could nevertheless charge NSP interest on its 1980, 1983, and 1984 tax year underpayments without regard to NSP's overpayments of its 1981 and 1982 tax obligations. Under this approach, the government treated NSP as a debtor for 1980, 1983 and 1984, and attempted to charge NSP at the higher interest rate applicable since January 1, 1987 to underpayments. At the same time, the government sought to pay NSP interest on NSP's 1981 and 1982 overpayments at the lower rate applicable to overpayments. Had the government computationally "netted" or applied NSP's 1981 and 1982 overpayments against its 1980, 1983, and 1984 underpayments, the IRS could not have charged NSP *any* interest at the higher rate applicable to underpayments because NSP was, at all times, overpaid in the aggregate. By computing interest on a separate year basis rather than on a "netted" basis, the government sought to keep more than $460,000 that it would otherwise have had to pay to NSP as interest for the use of NSP's money.

NSP moved for summary judgment on the ground that the IRS was obligated to compute the interest owed to NSP by netting the overpayments against the underpayments. The district court granted NSP's motion, holding that in § 1511(b) of the Tax Reform Act of 1986 and its legislative history, Congress required the government to avoid the hardship created by differential interest rates by requiring the government to net overpayments of taxes against underpayments. (App. 15.) The district court determined that Congress did not intend the government to engage in interest arbitrage to extract additional sums from taxpayers, such as NSP, who are net creditors of the government, and rejected the government's claims that netting was so administratively burdensome to implement with respect to taxpayers nationwide that netting should not be required in NSP's case. (*Id.*) The government appealed.

The Eighth Circuit reversed, holding that the district court erred by relying upon § 1511(b) of the Tax Reform Act (the same Act that initially created the interest rate differential) and the Act's legislative history. (App. 1.) Instead, the Eighth Circuit held that the answer to the question of whether interest netting is required is controlled by § 6402(a) of the Code, an IRS collection remedy that has existed in various statutory formulations since the 1930's, long before any interest netting issues had been addressed by Congress. The Eighth Circuit held that NSP's payment of the $23.6 million of assessments meant that NSP's original underpayments were no longer "outstanding," a circumstance which, in the Eighth Circuit's view, precluded the IRS from netting for NSP's benefit under § 6402(a). Moreover, the Eighth Circuit held that interest netting is, in any event, entirely discretionary with the IRS. It held that the IRS could refuse to net even in those cases in which a taxpayer's underpayments do remain "outstanding" at the time the interest computation is performed and could be satisfied, if the IRS chose,

by crediting the taxpayer's overpayments against such underpayments.

NSP petitioned for rehearing, arguing, *inter alia*, that the Eighth Circuit had confused the IRS' collection remedies under § 6402(a) with the concept of "interest netting" under §§ 6601(f) of the Code and 1511(b) of the Reform Act. Section 6402(a) is a debt collection provision, while "interest netting" is an accounting method under which the dates and amounts of a taxpayer's overpayments and underpayments are retrospectively determined and computationally applied against each other for the purpose of equitably computing interest. NSP further emphasized that the Eighth Circuit's decision conferred upon the IRS unprecedented discretion to raise or lower taxpayer refunds or debts at its whim and was flatly inconsistent with the interest netting decision of the Court of Appeals for the Seventh Circuit in *Pettibone Corp. v. U.S.*, 34 F.3d 536 (7th Cir. 1994). NSP further contended that it was error for a court to seek the purported "plain meaning" of the Internal Revenue Code by focusing on isolated language without weighing the purpose, function, and interplay of the various provisions of the Code or considering pertinent legislative history. Lastly, NSP noted the absurdity resulting from the Eighth Circuit's interpretation of the Code, under which taxpayers who pay underpayments are foreclosed, as a matter of law, from ever receiving the benefits of interest netting, while those taxpayers who consistently fail or refuse to pay underpayments may be given the benefit of netting.

REASONS FOR GRANTING THE WRIT

I. THE EIGHTH CIRCUIT HAS HANDED THE IRS UNBRIDLED DISCRETION TO UNJUSTIFIABLY EXTRACT ENORMOUS SUMS OF INTEREST FROM TAXPAYERS ACROSS THE NATION WHO ARE NOT TRULY INDEBTED TO THE GOVERNMENT.

A. Interest Netting Has Long Been Required By The Code's "Use Of Money" Principle.

The Internal Revenue Code requires a taxpayer to pay interest to the government when the taxpayer has underpaid taxes and, conversely, requires the government to pay interest when the taxpayer has overpaid taxes. 26 U.S.C. § 6621(a). As a general rule, the Code employs a strict "use of money" principle – the theory of which is that interest should be paid to that party whose funds have been held by the other. *Manning v. Seeley Tube & Box Co.*, 338 U.S. 561, 568 (1950); *Avon Products, Inc. v. U.S.*, 588 F.2d 342 (2d Cir. 1978). In Rev. Proc. 60-17, 1960-2 C.B. 942, the IRS explains the "use of money" principle as follows:

> Under the general rule, interest is paid on a tax overpayment for the time the government has the use of the taxpayer's money. Interest is collected, similarly, for the time the taxpayer has use of the government's money. *The underlying objective is to determine in a given situation whose money it is and for how long the other party had the use of it.*

Id. at § 2.01(1), 1960-2 C.B. at 942 (emphasis added).

Interest netting is an accounting mechanism for applying the Code's "use of money" principle when interest must be computed for multiple tax liability periods. Interest can be finally determined only retrospectively after the government and the taxpayer have resolved all tax disputes (often involving a number of tax

reporting periods), either through administrative means or after litigation. If in the aggregate a taxpayer has greater overpayments than underpayments for any group of audited and/or litigated tax periods, the taxpayer is not truly a debtor of the government, and the "use of money" principle would not permit the government to charge interest as if the taxpayer were a debtor. As discussed below, Congress has reaffirmed this principle in 1958, 1986, 1990, and 1994.

Even when interest rates on overpayments and underpayments were identical, Congress in 1958 took affirmative steps to insure that the respective interest obligations of taxpayers and the IRS were computed as strictly as possible under the "use of money" principle. In the Technical Amendments Act of 1958, Congress enacted what is now codified as § 6601(f) of the Code, which provides:

> **Satisfaction by credits**. If any portion of a tax is satisfied by credit of an overpayment, then no interest shall be imposed under this section on the portion of the tax so satisfied for any period during which, if the credit had not been made, interest would have been allowable with respect to such overpayment.

Congress added § 6601(f) to implement a strict "use of money" standard by requiring that separate tax overpayments and underpayments be treated as offsetting:

> The House bill eliminates these erratic differences of present law by terminating the interest both as to the overpayment and underpayment *during any period of time* to the extent that they offset each other.

Sen. Rep. No. 1983, 85th Cong., 2nd Sess., § 87(a), *reprinted in* 1958 U.S.C.C.A.N. 4791, 4888 (emphasis added). *Accord* H. Rep. No. 775, 85th Cong., 1st Sess. 45, *reprinted in* 1958-3 C.B. 811, 855. *See also Fruehauf Corp. v. U.S.*, 477 F.2d 568, 572 (Ct. Cl. 1973) ("The evil at which

the statute was aimed was the disparate running of interest on overpayments and underpayments, and the remedy provided by the Act was termination of the interest on both during any period of time to the extent that they offset each other").

The government itself has recognized that § 6601(f) requires the netting of overpayments and underpayments for interest computation purposes. In *Pettibone Corp. v. U.S.*, 34 F.3d 536 (7th Cir. 1994), the government argued that § 6601(f) "calls for interest to run for or against the taxpayer depending upon whether the current 'balance' is a net overpayment or underpayment." (Brief of the United States in No. 93-4027 at p. 21). In that same brief, the government described Congress' purpose in adding § 6601(f) (and in also amending § 6611(b)(1) relating to overpayment interest) as follows:

> The purpose of those changes was to ensure that, in the case of a credit of an overpayment against an underpayment, *neither the taxpayer nor the Government would receive interest for any period during which such obligations are mutually offsetting* . . . The implication of the legislative history of the 1958 Act is that overpayments and underpayments are mutually offsetting obligations for any period during which they both would bear interest if the credit had not been made.

(*Id.*, at 46) (emphasis added).

In short, in order to implement the "use of money" concept to the fullest extent feasible, § 6601(f) adopts netting principles for interest computations any time that mutually offsetting overpayments and underpayments exist. Because § 6601(f) incorporates netting to accomplish a "use of money" interest computation, it requires netting regardless of whether the IRS transfers the overpayment on its books to the underpayment account to

satisfy an "outstanding" underpayment delinquency, whether the taxpayer eventually pays the underpayment with cash, or whether the overpayment and underpayment remain entirely separate and unapplied on the IRS' books of account. Section 6601(f) operates in this fashion because it is purely an interest computation accounting method and not a debt collection provision. *Pettibone Corp.*, 34 F.3d at 539.

B. The Government's Refusal To Implement Interest Netting Principles To Offset Overpayments Against Underpayments Has Serious Financial Consequences To Taxpayers Across the Nation.

When § 6601(f) was first enacted in 1958, the interest rate owed to the government for tax underpayments was identical to the interest rate paid by the government on overpayments. The "evil" then being remedied by § 6601(f) involved relatively minor differences in interest obligations caused by statutory differences in the dates on which interest first began to run on certain underpayments and overpayments. *See e.g., New River Co. v. U.S.*, 30 F. Supp. 239 (Ct. Cl. 1939); *Babcock & Wilcox Co. v. Pedrick*, 212 F.2d 645 (2d Cir. 1954), *cert. denied* 348 U.S. 936 (1955); *Pan American World Airways v. U.S.*, 119 F. Supp. 144 (S.D.N.Y. 1953). Today, however, the government may pay a significantly lower rate of interest on overpayments than it charges taxpayers on underpayments, making the issue of interest netting a far more profound problem for all taxpayers.

In 1986, Congress for the first time created a 1% rate differential between the interest paid by the government to taxpayers on overpayments and the interest collected by the government on underpayments. Tax Reform Act of 1986, § 1511(a). Congress later increased the interest rate spread for many corporate taxpayers to as much as 4½%.

The Omnibus Budget Reconciliation Act of 1990 ("OBRA") enacted the so-called "hot interest" rules now codified at 26 U.S.C. § 6621(c). The interest rate differential was thereby increased to up to 3% on deficiencies exceeding $100,000 for any tax period. The Uruguay Round Agreements Act ("GATT") further widened the spread to as much as 4½% for corporate taxpayers, as of January 1, 1995 by decreasing by 1½% the interest rate owed by the government on any overpayment of more than $10,000.

The differing interest rates for overpayments and underpayments have an enormous impact. In NSP's case, at just a 1% rate differential, the government's refusal to net NSP's 1980-84 overpayments and underpayments during the period from January 1, 1987 until NSP paid the assessed $23.6 million in 1990 (during which period NSP was at all times a net creditor of the government)[1] has cost NSP some $460,000 in interest. When the interest rate spread is increased to its current 4½% differential, compounded daily, the government's ability to play "interest arbitrage" by refusing to net can have enormous and irrational financial consequences.

By refusing to follow the Code's "use of money" principle by netting overpayments and underpayments when computing interest, the IRS can turn a taxpayer from a net creditor into a net debtor by the time a tax controversy has concluded. In the following example, the IRS could extract an additional $8 million from a taxpayer simply by refusing to compute interest on a netting basis:

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[1] As noted above, NSP's "creditor" status for tax years 1980 through 1984 does not even include the erroneous $23.6 million assessments made by the government in 1990 and paid by NSP in that year. NSP's payment of the $23.6 million merely increased its creditor status by that sum.

> Assume that a taxpayer overpays its 1994 tax liability by $10 million, but underpays its 1995 tax liability by $9 million. The interest rate differential is 4½% (6½% accruing on overpayments, and 11% on underpayments). When the $9 million underpayment for 1995 arises, the IRS will owe the taxpayer $10 million for the 1994 overpayment plus one year of overpayment interest, for a total of $10.7 million. If this amount is then computationally "netted" against the $9 million underpayment in 1995, the IRS will owe the taxpayer a net refund of $1.7 million and the taxpayer, as a net creditor, would never incur a penny's worth of interest at the higher underpayment rate.
>
> If netting is not performed, however, interest accrues separately on the underpayment and overpayment at the differential rates. The taxpayer's status as a net creditor in the amount of $1.7 million rapidly evaporates. Before the end of a three-year IRS examination, the taxpayer would lose some $800,000 to interest arbitrage. After three more years, it would not only lose the $1.7 million that the IRS had originally owed it but it would then owe the IRS roughly $500,000. Within ten years after the due date of the 1995 return, it would lose more than $8 million simply as a result of the IRS' failure to net.

As is apparent, during the years typically required to conclude a complex tax dispute (such as the one at bar), the IRS can manipulate a taxpayer's liability in a wholly artificial manner by simply refusing to net, with the size of this IRS-manufactured loss quickly becoming astronomical. Because of this potential for prejudice to taxpayers, whenever Congress has created or increased the interest rate differential between underpayments and

overpayments, it has expressly reaffirmed the government's obligation to compute interest using netting principles. As will be shown below, however, the IRS has failed to follow Congress' direction.

II. THE EIGHTH CIRCUIT'S DECISION IGNORES THE EXPRESS WILL OF CONGRESS ON THIS IMPORTANT ISSUE AND REFUSES TO HEED THIS COURT'S DIRECTION TO INTERPRET THE INTERNAL REVENUE CODE BY ASCERTAINING THE PURPOSE AND CONTEXT OF ITS PARTICULAR STATUTORY PROVISIONS.

In attempting to determine Congress' intent on the question of whether the IRS must computationally net overpayments and underpayments to avoid the unfair burden of interest rate differentials, the Eighth Circuit failed to comprehend the scope of § 6601(f), the very provision incorporated under the "interest" portion of the Code which requires interest netting to effectuate the "use of money" principle in computing the respective interest obligations of the IRS and taxpayers. The Eighth Circuit also failed to give any effective meaning to § 1511(b) of the Tax Reform Act of 1986, the interest netting provision which Congress enacted at the same time that it first created an interest rate differential in § 1511(a) of the Act. Indeed, § 1511(b) expressly incorporated § 6601(f)'s netting principles and applied them to the newly-adopted differential interest rate structure. The Eighth Circuit, however, ignored §§ 6601(f) and 1511(b) and, instead, relied upon § 6402(a), a tax collection remedy which was added to the Code in 1954, well before § 6601(f) was enacted and 32 years before interest netting to avoid differential interest rates ever became a necessity. Finally, the Eighth Circuit expressly refused to consider relevant legislative history regarding the Tax Reform Act of 1986 – history that clearly explains how

Congress intended these complex tax statutes to be interpreted and applied.

A. The Eighth Circuit Erred By Misreading § 1511(b) of the Tax Reform Act of 1986.

1. Congress Required Interest Netting When It Created The Differential Interest Rate System In 1986.

In § 1511(a) of the Tax Reform Act of 1986, Congress created the differential interest rate system by amending § 6621(a) of the Code to make the underpayment interest rate 1% higher than the overpayment rate. Significantly, at the same time that it first created the interest rate differential in § 1511(a), Congress in § 1511(b) of the Reform Act authorized the Treasury to adopt interim regulations, to be effective for not longer than a three-year period immediately following the enactment of the Reform Act, to coordinate the interest netting provisions of § 6601(f) with the differential rate system then being created by § 1511(a)'s amendment of § 6621(a) until such time as computerized netting could be implemented. The full text of § 1511(b) provides that:

> (b) COORDINATION BY REGULATION. – The Secretary of the Treasury or his delegate may issue regulations to coordinate section 6621 of the Internal Revenue Code of 1954 (as amended by this section) with section 6601(f) of such Code. Such regulations shall not apply to any period 3 years after the date of the enactment of this Act.

The reasons why Congress enacted § 1511(b) to authorize the coordination of the netting process by means of Treasury Regulations valid only for an initial three-year period were explained contemporaneously in Senate Report No. 99-313:

> Taxpayers subject to differential interest rates may have an underpayment for a type of tax in one taxable year and an overpayment for the same type of tax in another taxable year. The IRS requires substantial lead time to develop the data processing capability to net such underpayments and overpayments in applying differential interest rates. The bill, therefore, provides that the Secretary of the Treasury may prescribe regulations providing for netting of tax underpayments and overpayments through the period ending three years after the date of enactment of the bill. By that date, the Committee expects that the IRS will have implemented computerized netting procedures.

Sen. Rep. No. 313, 99th Cong., 2d Sess., *reprinted in* 1986 - 3 C.B. (Vol. 3) at 185.

Congress fully intended that netting principles would govern differential interest rate computations, but realized that, as a practical matter, a period of up to three years would be necessary for IRS computer reprogramming and/or upgrading before the IRS' netting computations would be fully computerized. Congress had already mandated strict netting in 1958 when it adopted § 6601(f). In the 1986 legislation, Congress restated the necessity for netting by referencing the need to coordinate the differential rate structure of § 6621 with the netting requirements of § 6601(f). Having again *required* netting, Congress in § 1511(b) merely gave some discretion to the IRS regarding how netting could be *implemented* prior to the IRS' comprehensive computerization of netting calculations. It authorized the IRS to issue short-term regulations to implement the pre-computerized phase of required netting. Indeed, Congress could not have logically authorized regulations to implement netting if netting was not the mandatory legal standard for computing interest.

The intent of Congress in addressing the need to implement netting in the short term through the issuance of regulations was further explained contemporaneously in Conference Report No. 99-841 which stated, in relevant part:

> Section 6601(f) provides that, to the extent a portion of tax due is satisfied by a credit of an overpayment, no interest is imposed on that portion of the tax. Consequently, if an underpayment of $1,000 occurs in year 1 and an overpayment of $1,000 occurs in year 2, *no interest is imposed in year 2 because of the rule of section 6601(f).* The IRS can at present net many of these offsetting overpayments and underpayments. Nevertheless, the IRS will require a transition period during which to coordinate differential interest rates with the requirements of section 6601(f). The Senate amendment, therefore, provides that the Secretary of the Treasury may prescribe regulations providing for netting tax underpayments and overpayments through the period ending three years after the date of enactment of the bill. By that date, the IRS should have implemented the most comprehensive netting procedures that are consistent with sound administrative practice.

H.R. Conf. Rep. No. 841, (Pt. II) 99th Cong., 2d Sess., 785 *reprinted in* 1986 U.S.C.C.A.N 4075, 4873 (emphasis added).

Following the enactment of §§ 1511(a) and (b), however, the IRS declined to issue a single regulation, revenue ruling, revenue procedure, or internal guideline to accomplish the interest netting of an overpayment for one tax period against the underpayment of another. Rather, the IRS simply continued its traditional practices of maintaining separate tax period accounts and computing interest separately. The IRS also continued its historical practice of utilizing its § 6402(a) offset debt collection

powers to credit an overpayment against a still "outstanding" underpayment. In such debt collection cases, the delinquent taxpayer would receive the resulting benefit of interest netting only because the overpayment would be credited by the IRS against the underpayment *as of* the date the taxpayer had first overpaid the tax being credited. However, taxpayers, such as NSP, who paid underpayments with cash, either as a pre-condition to filing a refund suit and/or to immediately stop the further running of interest, were denied any interest netting benefits, unless they could persuade the IRS personnel with whom they were dealing to agree to netting on an *ad hoc* basis.

2. Congress Has Reiterated The Interest Netting Requirement Each Time It Has Increased The Interest Rate Differential.

In enacting OBRA in 1990, Congress adopted the so-called "hot interest" rules applicable to large corporate tax deficiencies by further amending the Code to include the provisions presently set forth in § 6621(c). This provision widened the potential interest rate differential from 1% to 3% for corporate taxpayers. At the time that Congress increased the rate differential in this fashion, it did so fully cognizant of the IRS' continuing failure to implement broad-based differential interest rate computations. Congress fully realized also that the undesirably prejudicial effect upon taxpayers would only be exacerbated by the widening rate spread if the IRS continued its failure to compute interest on a netting basis. In Conference Report No. 101-964, Congress accordingly reiterated the need for the IRS to implement the requisite netting:

> Under present law, the Secretary has the authority to credit the amount of any overpayment against any liability under the Code (sec. 6402). To the extent a portion of a tax due is satisfied

> by a credit of an overpayment, no interest is imposed on that portion of the tax (sec. 6601(f)). The Secretary should implement the most comprehensive crediting procedures under section 6402 that are consistent with sound administrative practice.

H.R. Conf. Rep. No. 964, 101st Cong., 2d Sess., *reprinted in* 1990 U.S.C.C.A.N. 2374, 2806. The failure of the IRS to implement broad-based netting therefore remained entirely unacceptable to Congress at the time it handed the IRS the 3% spread and significantly raised the stakes riding on interest netting computations.

The IRS remained either unwilling or unable to comply with its netting obligations even as of August 1994 when Congress, in enacting GATT, further widened the possible interest rate spread to as much as 4½% for certain corporate taxpayers.[2]

Again aware in 1994 that the IRS had done nothing whatever to implement comprehensive interest netting, Congress in House Report No. 103-826(1) restated the above-cited quotation from Conference Report No. 101-964 (relating to the 1990 OBRA legislation), this time adding the concluding admonition that the most comprehensive crediting procedures consistent with sound administrative practice should be implemented "as rapidly as is practicable." H. Rep. 103-826(1), Subtitle B, 103rd Cong., 2d Sess., *reprinted in* 1994 U.S.C.C.A.N. 3773, 3950.

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[2] Corporate taxpayers thus face a differential of between 1% and 4½% depending upon certain conditions. Individual taxpayers currently face a 1% differential, but are additionally burdened to the extent they receive taxable overpayment interest but must pay non-deductible underpayment interest when the IRS refuses to net. *Miller v. U.S.*, 65 F.3d 687 (8th Cir. 1995); *cf., Redlark v. Comm'r.*, 106 T.C. No. 2 (1996).

The IRS has steadfastly maintained that its consistent refusal to net (unless it chooses to do so solely for its own benefit, as in *Pettibone*) is fully compliant with the expressed will of Congress. The IRS' refusal has extended even to situations, such as NSP's, in which the taxpayer has at all times fully overpaid its aggregate liabilities, has paid vastly excessive assessments only so that it could stop the running of interest and challenge the IRS in a refund suit, and has provided the government with a verifiably accurate netting computation.

B. The Eighth Circuit Erred By Relying Upon § 6402(a), Rather Than Upon §§ 6601(f) and 1511(b).

Instead of relying upon § 6601(f) of the Code and § 1511(b) of the Reform Act, the two interest netting provisions intended by Congress to govern interest netting calculations, the Eighth Circuit instead concluded that a taxpayer's right to netting is simply a function of whether the IRS elects under § 6402(a) to apply an overpayment, then owed to the taxpayer, against some other underpayment, then still owed to the IRS. Section 6402(a) is the Code provision dealing with the collection of an unpaid tax liability when the taxpayer has also overpaid some other tax. Section 6402(a) has historically functioned solely as one of the many tax collection remedies available to the IRS. It simply permits the IRS to collect an unpaid tax by means of an administrative setoff on its books. By exercising the § 6402(a) collection remedy, the IRS does not have to issue a refund check to a taxpayer who is still delinquent with respect to some other tax liability. As the IRS' own representative testified in this case, § 6402(a) is *not* an interest-netting provision at all.

The § 6402(a) collection remedy with its "may credit" phrase cannot conceivably control the entire field of

required interest netting. Section 6402(a) was enacted decades before the differential interest rate structure was first conceived. That offset remedy has existed in various statutory formulations since the 1930's. When § 6402(a) was added to the Code, the government paid the same rate of interest to taxpayers on overpayments as it collected from taxpayers on underpayments. Interest netting was unnecessary (except in certain anomalous situations later cured by the 1958 legislation) because the same ultimate interest obligations would result whether or not netting was performed.

Interest netting did not become a critical issue until the Tax Reform Act of 1986. Congress certainly could not have expressed any intent in 1954 through § 6402(a) concerning netting as a means of alleviating the prejudice caused by differential interest rates. When Congress enacted the differential rate system in 1986, it expressly referenced in § 1511(b) the interest netting provisions in § 6601(f) and *not* the debt collection provisions of § 6402(a). The Eighth Circuit was wrong in relying on § 6402(a) to determine whether and under what circumstances Congress intended interest netting to be required. Indeed, § 1511(b) and the legislative history cited above would have been entirely unnecessary if all Congress had intended was for the IRS to continue its historical practice of using § 6402(a) to collect delinquent taxes and to require interest netting *only* in those cases. The IRS had been employing § 6402(a) offsets in that fashion for decades before 1986.

Moreover, the Eighth Circuit's reliance on § 6402(a) demonstrates its fundamental misunderstanding of the nature of computational interest netting. As the IRS itself argued before the Seventh Circuit in *Pettibone Corp.*, interest netting is not debt collection; rather, interest netting is

a retrospective accounting method under which a taxpayer's simultaneously-existing overpayments and underpayments are offset solely for interest computation purposes. Interest netting is retrospective because it can be performed only *after* the taxpayer's correct tax obligation for each tax year has been finally determined. The interest netting method is also retrospective because it identifies each overpayment and underpayment and nets each of them as they arose in real time. The Eighth Circuit misunderstood the distinction between interest netting as an *accounting method* and the *debt collection* mechanism created by § 6402(a). By doing so, the Eighth Circuit has reached the absurd result that interest netting can benefit only delinquent taxpayers, while those taxpayers who pay (or overpay) their taxes can never obtain the benefits of netting.

C. The Eighth Circuit Erred By Ignoring Relevant Legislative History.

Provisions of the Internal Revenue Code "must be analyzed and construed within the framework of the Internal Revenue Code and against the background of the congressional purposes." *Bob Jones University v. U.S.*, 461 U.S. 574, 586 (1983).

Ascertaining Congress' intent in enacting any particular portion of the Code is made difficult by the technical complexity of the Code, the nuances of the particular words chosen by Congress, and the interrelationship of the Code's various provisions. For these reasons, this Court has rejected an approach to interpreting the Code which would begin and end solely with an analysis of individual words or phrases within a provision, taken out of the context of the Code as a whole:

> And it is well settled that, in interpreting a statute, the court will not look merely to a particular clause in which general words may be

> used, *but will take in connection with it the whole statute and the objects and policy of the law.*

Bob Jones University, 461 U.S. at 586 (emphasis in original) *quoting Brown v. Duchesne*, 19 How. 183, 194 (1857). As the Seventh Circuit bluntly put the matter in a tax case, the "plain meaning" rule cannot possibly be applied to parts of sentences in the Code and is, in any event, "silly" because statutory words are never "plain in themselves" and without regard to "other clues" to the writer's intentions. *First Chicago Corp. v. Comm'r*, 842 F.2d 180, 183 (7th Cir. 1988).

Due to the technical complexity of the Internal Revenue Code and the interrelationship of its many provisions, the use of legislative history to ascertain the meaning of particular provisions of the Code is particularly important. This Court and the lower federal courts have routinely analyzed the legislative history of tax legislation. *See e.g., Bob Jones Univ.*, 461 U.S. at 586; *U.S. v. Goodyear Tire and Rubber Co.*, 493 U.S. 132, 139-40 (1989); *U.S. v. Rodgers*, 461 U.S. 677, 706 (1983); *Albertson's, Inc. v. Comm'r*, 42 F.3d 537, 541, 546 (9th Cir. 1994), *cert. denied* 116 S.Ct. 51 (1995).

Congress reasonably expects that courts, agencies, and persons interpreting legislation, particularly the Internal Revenue Code, will consult the legislative history to find useful guidance. Indeed, as a practical matter, legislation may be enacted only because the concerns of legislators are addressed to their satisfaction in that history. *See* Breyer, THE 1991 JUSTICE LESTER W. ROTH LECTURE: ON THE USES OF LEGISLATIVE HISTORY IN INTERPRETING STATUTES, 65 S. Cal. L. Rev. 845, 871 (1992).

In this case, the Eighth Circuit's fundamental confusion of the Code's debt collection offset remedy under § 6402(a) with the Code's interest netting requirement

under § 6601(f) and § 1511(b) of the Reform Act arose out of its refusal to interpret the Code as a whole and its refusal to consider contemporaneous legislative history. Instead, the Eighth Circuit resolved to construe §§ 6402(a), 6601(f), and 1511(b) by going no further than a facial reading of those statutes to determine their purported "plain meaning."

Had the Eighth Circuit given the committee reports the fair weight they were reasonably due and had it considered the respective functions of §§ 6402(a), 6601(f), and 1511(b), it would have realized that interest netting is required even when any underpayments which had once existed have later been paid. Had it done so, it would have realized that in § 1511(b), Congress was permitting the IRS to issue regulations, valid only for up to three years, solely as a means to *implement* netting on an interim basis until computerized netting could be accomplished – not as a means to give the IRS discretion to net or not net at its whim and caprice.

In sum, Congress in § 1511(b) and the accompanying committee reports primarily addressed the practical issues relevant to the implementation of full-blown, computerized netting by the IRS because Congress realized that the IRS would require a start-up period in which to ready itself for later computerized netting. It was in this context only that Congress granted the IRS short-term authority to issue netting regulations. In concluding that the *only* meaning of § 1511(b) is to hand the IRS discretion to net or not net interest obligations, the Eighth Circuit erred by trying to read the statute without reference to § 6601(f), Congress' intent, and the context in which the netting regulations were to function. Read as the Eighth Circuit has construed it, § 1511(b) is utterly meaningless. The Treasury *already* had full regulation-writing power

under § 7805(b) of the Code. Section 1511(b) was absolutely unnecessary if all Congress wanted to accomplish was to authorize netting regulations in the IRS' discretion. Because Congress had already adopted interest netting principles in § 6601(f) and incorporated those principles into the differential interest rate system by its express reference in § 1511(b) to § 6601(f), interest netting is mandatory under the Code.

D. The Eighth Circuit Has Granted The IRS Unprecedented Discretion To Play Interest Arbitrage To The Financial Detriment Of Taxpayers.

A remarkable and potentially insidious aspect of the decision of the Eighth Circuit is its holding that Congress has given the IRS full discretion either to apply or not apply interest netting principles on a case by case basis. This decision affords the IRS power that neither Congress nor any appellate court has ever previously granted to the IRS: the power, through a sheer act of undefined discretion, to increase or decrease the amount owed either by or to a particular taxpayer. The determination of the precise amounts either owed to or by a taxpayer has always been treated as subject to the defined legal standards contained in the Code, Treasury Regulations, and case law. Congress has never permitted the IRS, simply at its whim, to increase or decrease the correct amount owed by or to the taxpayer as a result of its examination of the taxpayer's returns. Of course, *after* the correct liability has been established, the IRS does retain broad discretion as to how much of an unpaid tax it will seek to collect and how it will do so. The Eighth Circuit, however, reached a result which confers unprecedented discretion upon the IRS to raise or lower a taxpayer's obligations in the first instance because it erroneously

applied § 6402(a)'s discretionary collection power to the interest obligation area which involves determining the correct amounts owed, entirely without regard to any IRS collection discretion.

Given the enormous amounts of interest involved, it is inconceivable that Congress could have intended to hand the IRS such a potent measure of uncontrolled discretion. Certainly, in view of Congress' repeatedly expressed concern that netting must be implemented, any conclusion that all that Congress desired was for the IRS to do whatever it wanted, no matter how much harm taxpayers might suffer, is simply unfathomable. The Eighth Circuit's decision offers not the slightest hint as to which IRS national office, district office, or service center personnel possess the power to raise or lower, by tens of millions of dollars annually, taxpayers' refunds or debt obligations; what principles, if any, might conceivably govern that discretion; or when any particular IRS refusal to net would be an abuse of discretion.

By its grant of this discretion, the Eighth Circuit has not only endorsed the harm which results from the IRS' failure to employ netting principles, but it has also opened the door to mischief resulting from the overt manipulation of a taxpayer's overpayments and underpayments. The decision invites the IRS not to credit overpayments even in cases in which the underpayments do remain "outstanding" and in which the IRS has historically used its offset powers to credit an overpayment. There is now no visible restraint upon the IRS' simply refunding overpayments to a taxpayer, like NSP, while billing the taxpayer separately for its underpayments. The IRS has traditionally collected only the taxes and interest owed under the Code. Under the Eighth Circuit's decision, however, it may extract additional sums, in its

discretion, by engaging in interest arbitrage activities at taxpayers' expense.

E. The Eighth Circuit's Decision Arbitrarily Penalizes Taxpayers Whatever They Do.

The Eighth Circuit's decision places taxpayers in a hopeless, no-win crossruff. At a minimum, it hands another powerful bargaining chip to the IRS in the tax examination and tax litigation process. If the IRS issues a notice of deficiency with which the taxpayer disagrees, the taxpayer will often find it necessary to pay the deficiencies, even though it has resolved to contest them. *See Flora v. United States*, 362 U.S. 145 (1960) (requiring full payment by the taxpayer before commencing a refund suit). Moreover, because the asserted deficiencies, if later sustained, continue to accrue interest at the steep underpayment rate, the taxpayer may often find it wise to pay promptly and thereby stop the further running of any underpayment interest prior to filing suit. Under the Eighth Circuit's ruling, however, the taxpayer's decision to pay the asserted deficiencies absolutely precludes the taxpayer from *ever* claiming the benefits of netting because any asserted underpayments will, by definition, no longer be "outstanding" when the dispute is finally resolved. The Eighth Circuit's decision never explains why Congress would seek to penalize taxpayers for paying asserted deficiencies or for exercising the right to sue for a refund.

However, not paying the underpayments asserted by the IRS now exposes the taxpayer to even greater damage. Because the Eighth Circuit has granted the IRS the discretion to refuse to net overpayments even against such "outstanding" underpayments, taxpayers who do not pay may end up in the worst of both worlds, with their underpayments continuing to accrue interest at the

Code's substantial underpayment rate *and* without the benefit of netting should the IRS, at its pleasure, decline to net. Given the large sums to be made by the IRS nationwide through this form of interest arbitrage, when, one may legitimately ask, would the IRS ever net for a taxpayer's benefit? And when, one might further ask, would the IRS do so without first extracting some monetary concession from the taxpayer? At a minimum, the discretion accorded to the IRS now makes settlements of audit examinations and litigation far more difficult because it injects interest resolution issues, as well as tax issues, into the mix. Interest determinations should follow, like the night follows the day, from tax determinations. Under the Eighth Circuit's decision, such no longer is the case.

III. THE DECISION OF THE EIGHTH CIRCUIT CONFLICTS WITH A DECISION OF THE SEVENTH CIRCUIT.

In *Pettibone Corp. v. U.S.*, 34 F.3d 536 (7th Cir. 1994), the IRS examined the income tax returns of a corporate taxpayer for years 1973 through 1985 preparatory to filing a proof of claim against the taxpayer in a pending bankruptcy proceeding. The IRS and the taxpayer agreed that, if each year were treated separately, the taxpayer had underpaid three of the years, but had overpaid each of the other ten tax years. Because the taxpayer had filed a bankruptcy petition, however, the IRS would have been precluded from charging the taxpayer any interest on its underpayments following the filing of the bankruptcy petition, but would have been obligated to pay the taxpayer interest on its overpayments. As a result of this adverse interest whipsaw, the IRS would have owed the taxpayer $254,054 as of the time the IRS' claims were tried in the Bankruptcy Court if each of the thirteen tax

years was treated separately for interest calculation purposes.

The IRS argued, however, and the Seventh Circuit agreed, that the taxpayer's overpayments and underpayments should be computed by the "continuous netting of overpayments, underpayments, and interest on the balance," with the result that the taxpayer owed the IRS $2,379,189 as of the date the bankruptcy petition was filed. *Pettibone Corp.*, 34 F.3d at 538. The IRS performed this continuous netting exercise chronologically by applying overpayments and underpayments as each arose. Under this method, the net overpayment or underpayment balance increased or decreased as each overpayment or underpayment was retrospectively found to have existed, and as interest was added to the net running balance. In sum, the IRS reshuffled the entire deck by blending all overpayments and underpayments as they had occurred in real time. In this process, the IRS computed interest on the thirteen separate year tax accounts as if they constituted one aggregate combined account.

The taxpayer objected to netting on the ground that it constituted a collection setoff prohibited by the Bankruptcy Code. Judge Easterbrook, writing for the Seventh Circuit, rejected that contention on the ground that netting is "an accounting method" and not a "setoff" or "offset" prohibited by the Bankruptcy Code. *Pettibone Corp.*, 34 F.3d at 539. The Seventh Circuit not only found that netting did not constitute a collection effort, but it also determined that netting was particularly appropriate in the case of corporate taxpayers because their individual years are truly interdependent and are, in reality, but intermediate steps in determining their overall present tax liability. In fact, in the Seventh Circuit's view, a failure to net for corporate taxpayers would make no sense.

While the Seventh Circuit concluded that interest netting is not debt collection under § 6402(a) and is, rather, an interest computation accounting method, the Eighth Circuit has reached an entirely opposite result, concluding that interest netting is impossible except when the IRS performs debt collection under § 6402(a). These characterizations are irreconcilable.

The Eighth Circuit incorrectly read *Pettibone Corp.* as fully supportive of the IRS' position in NSP's case on the grounds that (1) the Seventh Circuit treated netting as entirely discretionary with the IRS and (2) the IRS in *Pettibone Corp.* had merely netted overpayments against "outstanding" liabilities. The Eighth Circuit is demonstrably wrong on both grounds. First, the Seventh Circuit did not hold that netting is discretionary with the IRS; on the contrary, the Seventh Circuit concluded that a failure to net in the case of a corporate taxpayer would be artificial and lack "sense." Indeed, the Seventh Circuit expressly noted that any delay in the IRS crediting overpayments and underpayments might cause "impermissible prejudice" to the taxpayers, given the interest rate differential. *Pettibone Corp.*, 34 F.3d at 541.

What the Seventh Circuit *did* find discretionary on the part of the IRS is whether an overpayment should be refunded to a delinquent taxpayer or applied against any delinquencies. With that statement, NSP is in total agreement. The critical point that the Eighth Circuit completely missed, however, is that whether or not the IRS elects to refund an overpayment to a delinquent taxpayer cannot impact the amount of interest which is owed between the parties. Because the net interest owed as between the IRS and a taxpayer reflects the *past* "use of money" over a specific period of already-elapsed time, such amount cannot logically or mathematically be affected by some *subsequent* administrative event such as whether the IRS

refunds or, instead, credits the overpayment or whether (as in NSP's case) the taxpayer sends a check to the IRS for sums which more than eliminate the underpayment. Only because it consistently failed to understand the distinction between the IRS' collection crediting activities and computational interest netting did the Eighth Circuit interpret interest netting as controlled by debt collection.

Secondly, the Eighth Circuit is simply wrong in portraying *Pettibone Corp.* as a case merely involving the crediting of overpayments against "outstanding" underpayments. In *Pettibone Corp.*, the thirteen separate tax years were blended into one continuous chronological account which reflected the aggregate balance overpaid or underpaid, with interest running only on the net balance. Indeed, the word "outstanding" is wholly absent from the Seventh Circuit's decision precisely because the IRS had continuously netted all overpayments and underpayments as each of them had arisen and without regard to whether any individual tax year was overpaid or was underpaid. What the Eighth Circuit failed to appreciate is that the IRS' interest netting methodology in *Pettibone Corp.* is precisely that which is required by the Code and sought by NSP.

CONCLUSION

On one point NSP, the government, and tax professionals are all agreed: whether interest on the respective obligations of the IRS and taxpayers is computed utilizing netting principles is of enormous and overriding importance to the IRS and taxpayers across the country. The Eighth Circuit's decision has publicly drawn both concern and strong criticism from a host of sources. *See e.g.*, INTEREST DIFFERENTIALS MAKE NETTING A MAJOR ISSUE, Tax Notes (January 15, 1996); and N. Jerold Cohen, FROM THE CHAIR, ABA Section of Taxation Newsletter

(Spring 1996) (in which a former IRS Chief Counsel has described the Eighth Circuit's decision as one which "threw both legislative history and tax policy to the wind" and which "completely disregards the complexity of our tax system"). The IRS' insistence on charging interest even when a taxpayer has overpayments has also been cited in the January 1996 Report of the National Commission on Economic Growth and Tax Reform ("Kemp Commission") as an example of an IRS practice which makes "little sense." The enormous financial impact aside, the netting issue raises a matter of fundamental fairness in the IRS' dealings with taxpayers and the extent to which the IRS may decide for itself how to apply the law contrary to repeated expressions of legislative intent. This case raises fundamentally important questions regarding how federal courts must read tax statutes and how much discretion they are free to accord the IRS. To resolve these issues of great importance in the administration of the tax laws and the conflicting conceptual approaches of two circuits, this Court should grant NSP's petition.

Dated: July 3, 1996.

Respectfully submitted,

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UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 95-1306MN

Northern States Power Company, a Minnesota Corporation, and Northern States Power Company, a Wisconsin Corporation, Appellees,	* * *

have the interest on its tax refunds computed by offsetting, or "netting," its tax underpayments in 1980, 1983, and 1984 against its overpayments in 1981 and 1982. This "netting" approach eliminates the expensive – for NSP – effect of a one per cent. difference between the interest rates on overpayments and underpayments, that is, between what the Government pays and what it earns.[1] The United States argues that the tax laws give the IRS discretion to credit a taxpayer's overpayment against the same taxpayer's outstanding liability, and that overpayments and underpayments may be "netted" for interest-calculation purposes only when the IRS decides to make such a credit. We agree, and reverse.

I.

The relevant facts of this case are not contested. In 1990, after an audit, the IRS rejected several of NSP's claimed deductions and assessed tax deficiencies against NSP for 1980, 1981, 1983, and 1984. That same year, NSP paid the IRS over $23 million for the deficiencies, plus interest. NSP then filed amended returns, asserting previously unclaimed tax credits for 1981, 1982, and 1984, and brought this case, seeking refunds based on these credits.

In 1994, NSP and the IRS settled most of their disputes. They agreed that NSP had overpaid its taxes in 1981 and 1982, but underpaid in 1980, 1983, and 1984.

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[1] Congress set the interest rate owed by a taxpayer on underpayments one per cent. higher than the rate paid to a taxpayer on overpayments in the Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085, § 1511(a). The rates have changed several times since then, but the rate itself does not matter here.

And because the agreed-upon deficiencies for 1980, 1983, and 1984 were smaller than was thought when NSP paid its $23 million deficiency, it turns out NSP actually overpaid for all five years.[2] So the parties agree that NSP is entitled to refunds plus interest for all five years in question (1980-84). Here, however, NSP and the IRS part company; they do not agree on how to calculate the interest due on the refund. This disagreement is the subject of this appeal.

What makes this case interesting is the gap between the interest rates on underpayments and overpayments. See I.R.C. (26 U.S.C.) § 6621(a). If interest accrued on underpayments and overpayments at the same rate, the parties' disagreement would evaporate. That is, it would make no difference if underpayments and overpayments were "netted," and the applicable interest rate then applied to the difference, or if interest accrued, at the applicable rates, simultaneously and separately on the overpayments and the underpayments. Either way, it would all come out in the wash. But the rates are not the same, so netting can, in some cases, save – or cost – a great deal.[3]

In this case, before NSP paid the deficiencies in 1990, it had overpaid in 1981 and 1982 more than it underpaid in 1980, 1983, and 1984. The United States argues that the

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[2] The parties stipulated the following overpayments: in 1980, $1,846,947; in 1981, $5,616,786; in 1982, $130,238; in 1983, $311,663; and in 1984, $1,212,867. In all, NSP overpaid $9,118,501.

[3] The "netting" method of interest calculation would entitle NSP to an additional $460,000.

interest due NSP should be calculated separately for each of the tax years in question. But NSP insists the IRS should credit its 1981 and 1982 overpayments against its 1980, 1983, and 1984 underpayments *as of the time the underpayments arose.* If the IRS takes this "netting" approach, the interest rate gap does not come into play because, on balance, NSP was, during the relevant years, the United States' creditor, not debtor.

II.

A.

The District Court granted NSP's motion for summary judgment, and held that NSP is "entitled to have the interest on its tax refunds for 1980 through 1984 computed by netting the 1981 and '82 overpayments against the '80, '83, and '84 underpayments." The Court agreed with NSP that the 1986 Tax Reform Act, Pub. L. No. 99514, § 1511(b), 100 Stat. 2085, showed Congress's "specific concern about potential unfairness to taxpayers, [who] had an overpayment in one year and an underpayment in another. . . . " The Court stated that "[t]he legislative history which accompanies the Act is explicit in providing that the Service should adopt and implement computerized netting procedures" to "eliminate the unfairness" caused by the higher interest rate for underpayments. Without disparaging the Court's unease with what it perceived to be IRS overreaching, we disagree with its decision. We think this case is controlled by the

text of the Internal Revenue Code, not by the Tax Reform Act's, or any other, legislative history.[4]

B.

Our analysis starts, and in this case ends, with the statutes themselves. See *Staples v. United States*, 114 S. Ct. 1793, 1797 (1994) (a statute's language is "the starting place in [a court's] inquiry"); *Arkansas AFL-CIO v. F.C.C.*, 11 F.3d 1430, 1440 (8th Cir. 1993) (when Congress's intent is clear from the words of the statute, that is the "end of the judicial inquiry"). We think that when, as here, the statutes are straightforward and clear, legislative history and policy arguments are at best interesting, at worst distracting and misleading, and in neither case authoritative. See *Davis v. Michigan Dept. of the Treasury*, 489 U.S. 803, 808 n.3 (1989) ("Legislative history is irrelevant to the interpretation of an unambiguous statute."); *United States v. Field*, 62 F.3d 246, 249 (8th Cir. 1995) (when the statutory language is not ambiguous, there is "no need to search for clues to Congress' intent in the legislative history").

As both parties recognize, the Internal Revenue Code does provide for the type of "netting" sought by NSP in this case. Under Section 6601(f) of the Code (26 U.S.C.):

> If any portion of a tax is satisfied by credit of an overpayment, then no interest shall be imposed

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[4] In its brief, NSP points to the legislative history of other statutes passed since the 1986 Act. The District Court, however, mentioned only the 1986 Act's history when it granted NSP's motion for summary judgment.

> under this section on the portion of the tax so satisfied for any period during which, if the credit had not been made, interest would have been allowable with respect to such overpayment.

So, the IRS may credit a taxpayer's overpayments against its underpayments and thereby sidestep the effect of Section 6621's interest-rate gap. But must it do so in this case?

Section 6601(f)'s netting provision is an exception to the general rules for calculating interest on overpayments and underpayments. See I.R.C. §§ 6601(a); 6611(a), (b)(1), (2).[5] The statute makes it plain that its netting provision

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[5] I.R.C. § 6601(a) provides:

> *General Rule.* – If any amount of tax imposed by this title (whether required to be shown on a return, or to be paid by stamp or by some other method) is not paid on or before the last date prescribed for payment, interest on such amount at the underpayment rate established under section 6621 shall be paid for the period from such last date to the date paid.

. . . I.R.C. § 6611 states:

> (a) *Rate.* – Interest shall be allowed and paid upon any overpayment in respect of any internal revenue tax at the overpayment rate established under section 6621.
>
> (b) *Period.* – Such interest shall be allowed and paid as follows:
>
> (1) *Credits.* – In the case of a credit, from the date of the overpayment to the due date of the amount against which the credit is taken.
>
> (2) *Refunds.* – In the case of a refund, from the

comes into play "[i]f any portion of a tax is satisfied by credit of an overpayment." Turning next to Section 6402(a) (Authority to Make Credits or Refunds), we find this provision:

> *General Rule.* – In the case of any overpayment, the Secretary, within the applicable period of limitations, *may* credit the amount of such overpayment, including any interest allowed thereon, against any liability in respect of an internal revenue tax on the part of the person who made the overpayment and shall, subject to subsection (c) and (d), refund any balance to such person (emphasis added).

Accordingly, the applicable Treasury regulation states that "[t]he Commissioner . . . *may* credit any overpayment of tax, including interest thereon, against any outstanding liability . . . owed by the person making the overpayment. . . . " 26 C.F.R. § 301.6402-1 (1995) (emphasis added).

We agree with the United States that the word "liability" in Section 6402 means "*outstanding* liability," one that is unpaid when the credit is made. The Treasury regulations support this reading, see 26 C.F.R.

> date of the overpayment to a date (to be determined by the Secretary) preceding the date of the refund check by not more than 30 days, whether or not such refund check is accepted by the taxpayer after tender of such check to the taxpayer. The acceptance of such check shall be without prejudice to any right of the taxpayer to claim any additional overpayment and interest thereon.

. . .

§ 301.6402-1 (referring to an "outstanding liability"), and we properly defer to these regulations. See *Cottage Savings Ass'n v. Commissioner*, 499 U.S. 554, 560-61 (1991) (courts "must defer to [the Commissioner's] regulatory interpretations of the code so long as they are reasonable"); *Miller v. United States*, 65 F.3d 687, 689 (8th Cir. 1995) (same). This is also the reading that makes the most sense, because only an outstanding liability can be "satisfied" by a credit. See I.R.C. § 6601(f). NSP provides no support, other than a strained reading of miscellaneous bits of legislative history, for its assertion that Section 6402(a) is somehow "time-neutral," that a "liability" may be one that no longer exists, but once did. We think this argument withers before the statute's plain meaning. We are likewise not convinced by NSP's attempt to read the word "outstanding" out of the relevant Treasury regulation, 26 C.F.R. § 301.6402-1. In our view, the regulation means what it says.

So there must be an outstanding tax liability, against which an overpayment may be credited, before Section 6402's netting exception comes into play. But even assuming such a liability, the IRS has discretion whether to credit an overpayment to that liability or not. Section 6402 is clear: the IRS "*may* credit the amount of such overpayment . . . against any liability." See, *e.g.*, *In re Ryan*, 64 F.3d 1516, 1523 (11th Cir. 1995) ("[Section 6402], plainly gives the IRS the discretion to apply overpayments to any tax liability."); *Pettibone Corp. v. United States*, 34 F.3d 536, 538 (7th Cir. 1994) (statute "leaves to the Commissioner's discretion whether to apply overpayments to delinquencies or to refund them to the taxpayer"); *Estate of Bender v. Commissioner*, 827 F.2d 884, 887

(3d Cir. 1987) (discretionary power under § 6402(a) "rests exclusively with the IRS").

NSP argues that – the IRS's statutorily granted discretion notwithstanding – Congress has repeatedly insisted that the IRS develop comprehensive and computerized interest-netting procedures, to eliminate the possibility of unfairness caused by the interest-rate gap. NSP cites no case or statutory authority for this argument. Instead, NSP purports to glean a mandate for netting from the 1986 Tax Reform Act and its legislative history, as well as from the history of several later enactments. NSP notes that when Congress passed the 1986 Tax Reform Act, it authorized the Treasury Department to "coordinate" Section 6621's different interest rates for under- and overpayments with Section 6601(f)'s netting provision. Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085, § 1511(b).[6] NSP explains, citing legislative history, that Congress recognized the IRS's need for

> substantial lead time to develop the data processing capability to net . . . underpayments and

---

[6] Section 1511(b) states:

> . . .
>
> (b) COORDINATION BY REGULATION. – The Secretary of the Treasury may issue regulations to coordinate section 6621 of the Internal Revenue Code . . . with section 6601(f) of such Code. Such regulations shall not apply to any period 3 years after the date of the enactment of this Act.
>
> . . .

We note that this section says the Secretary "may" issue regulations to coordinate the two Code sections. This is not a mandate.

> overpayments in applying differential interest rates. The bill, therefore,provides that the Secretary of the Treasury may prescribe regulations providing for netting of tax underpayments and overpayments through the period ending three years after the date of enactment of the bill. By that date, the committee expects that the IRS will have implemented computerized netting procedures.

S. Rep. No. 313, 99th Cong., 2d Sess. 185, *reprinted in* 1986-3 C.B. (Vol. 3) v., 185 ; see also H.R. Conf. Rep. No. 841 (Pt. II), 99th Cong., 2d Sess. 785, *reprinted in* 1986-3 C.B. (Vol. 4) v., 785 (noting that, after three years, "the IRS should have implemented the most comprehensive netting procedures that are consistent with sound administrative practice").

According to NSP, Congress has continued to call for netting of overpayments and underpayments in the legislative history of enactments since 1986. As we said above, however, all this rummaging through the legislative history of statutes other than those at issue is beside the point. See *Consumer Product Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 117 (1980) (" 'the views of a subsequent Congress form a hazardous basis for inferring the intent of an earlier one' ") (citation omitted). The relevant statutes are, we think, quite clear, and we are not convinced that NSP's litany of congressional reports amounts to anything like a mandate. Congress knows very well how to mandate something; it has not done so here. A statement in a report that a committee of Congress "expects" an agency to do something does not have the force of law. The agency may, and probably should,

heed such a statement, but a court will not enforce it when the statute itself contains no warrant for doing so.

Thus, the IRS may credit an overpayment against an outstanding liability, and, if it does, Section 6601(f)'s netting provision comes into play. In this case, however, not only has the IRS apparently chosen not to credit the overpayments, there were no outstanding liabilities against which the overpayments might be credited. NSP paid off its tax deficiencies, and then some, in 1990. It then amended its returns and established that it was entitled to refunds, though not to a credit, because, again, it no longer had any outstanding tax liabilities. Under Section 6402, then, the IRS could not credit the overpayments, and so Section 6601(f)'s netting rule does not apply. And we emphasize again that even if NSP had had outstanding liabilities, the IRS is not required to credit overpayments against them, and therefore not required to do the comprehensive netting described in Section 6601(f). In a proper case, the failure to credit overpayments might be reviewable on an abuse-of-discretion basis, but no such argument is made in this case.

IV.

In our view, the language of the relevant statutes answers the question raised in this case. Still, we think it appropriate to comment on two other points discussed in the parties' briefs. First, the parties argue at some length about whether or not the IRS has the technological capacity to make interest netting its standard practice. NSP insists that the IRS routinely does extensive and complicated corporate-refund computations, and that interest

netting would not be inordinately burdensome on the IRS. The IRS, on the other hand, insists that implementing a comprehensive netting system would *not* be "consistent with sound administrative practice."[7]

We do not know if the IRS can do computerized comprehensive netting of the kind sought by NSP or not. But in this case the IRS's capabilities are irrelevant. The statutes are unambiguous, and do not require NSP's proposed accounting methods. If the law did require the IRS to calculate interest by netting overpayments and underpayments, so long as consistent with "sound administrative practice," then the IRS would have to start netting, or show that it could not.

Second, NSP argues that a Seventh Circuit case, *Pettibone Corp. v. United States*, 34 F.3d 536, supports its position. We disagree. In *Pettibone*, the court held that the netting of overpayments and underpayments was not a "setoff" within the meaning of the Bankruptcy Code. In *Pettibone*, as in this case, the IRS and the taxpayer agreed on the amount of underpayments and overpayments, but disagreed on how to net the two sums and on how to

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[7] NSP claims that in the legislative history of the Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, 104 Stat. 1388, and of the Uruguay Round Agreements Act ("GATT"), Pub. L. No. 103-465, 108 Stat. 4809, Congress demanded the Treasury develop "the most comprehensive crediting procedures under section 6402 that are consistent with sound administrative practice. . . . " H.R. Rep. No. 826(1), Subtitle B, 103d Cong., 2d Sess., *reprinted in* 1994 U.S. Code Cong. & Ad. News 3773, 3950; H.R. Conf. Rep. No. 964, 101st Cong., 2d Sess., *reprinted in* 1990 U.S. Code Cong. & Ad. News 2374, 2805-2806.

calculate interest. *Id.* at 538. Ironically, the parties' positions in *Pettibone* were the reverse of those here: the IRS argued for "continuous netting of overpayments, underpayments, and interest on the balance," while the taxpayer wanted to "tally the overpayments and the underpayments separately," with "interest also accru[ing] separately. . . . " *Ibid.* The court did not address whether or not netting was required, but simply held that the netting was not a prohibited setoff. *Id.* at 542. Thus, *Pettibone* has little to do with this case. Nevertheless, NSP argues that because the IRS argued for continuous netting in *Pettibone,* it must use continuous netting here.

We disagree. First, if the IRS were to argue that the tax laws require continuous netting, for interest-calculation purposes, of overpayments and underpayments, it would be mistaken. It is not estopped to take the correct position here. Second, in *Pettibone, the IRS credited outstanding* overpayments against *outstanding* underpayments, which it is permitted to do under Section 6402(a). The *Pettibone* court did discuss Section 6601(f)'s netting procedure, but nothing in that decision suggests netting is required when past underpayments have already been fully paid. In fact, the Pettibone court noted that, under Section 6402(a), the "Internal Revenue Code leaves to the Commissioner's discretion whether to apply overpayments to delinquencies or to refund them to the taxpayer," and emphasized that "[t]here are many reasonable interpretations of the provisions of the Internal Revenue Code. The IRS is free to choose among them." *Pettibone,* 34 F.3d at 538, 542.

V.

For the reasons discussed in this opinion, we reverse the judgment of the District Court, and remand for further proceedings consistent with this opinion.

A true copy.

Attest:

CLERK, U.S. COURT OF APPEALS, EIGHTH CIRCUIT.

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
FOURTH DIVISION
4-92-CV-74

Northern States Power Company)
)
v.)
)
United States of America)
)

* * *

[p. 28] THE COURT: The Court prefaces its determination by pointing out that it is not unconscious of the fact that the Internal Revenue Service and its counsel administrate a large, comprehensive, and a national program. The Court in almost any other context, would have been required to recuse itself from this case. It having at least on a few occasions represented the Internal Revenue Service as United States Attorney for this district. That, of course, does not constitute a conflict here. The Court recognizes the difficulties which befall the Internal Revenue Service as it goes about its work. The problem is, there are enough difficulties in the world that the Service does not need to go around manufacturing more difficulties for itself by taking utterly indefensible and totally unrealistic positions, and clinging to them as if they were reading from holy writ. And when they do that, it should fall to wise administration, wise counsel, to consider whether or not that is the efforts that they wish to spend their time and their credibility on.

[p. 29] The Court attempted, as it has throughout this case, to foster a settlement. And to try and encourage counsel to use their good efforts. But, when the parties

cannot resolve a question, as I believe was stated by counsel, the courts will have to resolve it when the parties won't or can't by themselves. And so I note that this matter is before the Court on cross motions for summary judgment.

Plaintiff's motion for summary judgment is granted.

This case arose out of a suit for the refund of income taxes and interest which had been claimed owed to the plaintiff, NSP, for excess taxes paid for tax years 1980 through 1984. The plaintiff properly filed this refund suit after having engaged in the predicate act of paying all taxes owed and suing in the United States District Court. The United States Congress authorized that position. And they have chosen whichever mechanism appealed to them as is given to them by the law.

In October of 1993, the parties actually settled this case. But it took ten months – ten months – for the agonizingly slow administrative process of the Internal Revenue Service and its justice department counsel to finally stumble along to approve the settlement which made sense at the time it was accomplished.

Finally, this past August, the bureaucracy agreed to resolve the underlying settlement. But the Service was not [p. 30] complete in its labors. Its slow grinding process has now stuck itself on a self-created grain of sand. Having been unable to digest the question of interest, it has now thrown back this problem before a court when it is obvious that a rational resolution was there and was available, and the question now lies unresolved before the Court.

In August 1994, the parties did settle the lion's share of this dispute by agreeing to all the amounts of actions

which were owed for tax years 1980 through 1984. The Service, having been unable to make the final decision, parties have reserved for this Court the final decision in the case. In particular, it is now the responsibility of the Court to calculate the interest on overpayments and underpayments made by the plaintiff relating to the disputed five-year tax period. The parties have each filed their cross motions to resolve this remaining issue, and have filed a lengthy stipulation which has been of assistance to the Court. The following facts are undisputed as part of the parties' stipulation:

Plaintiff has overpaid its federal income tax for each of the tax years 1980 through 1984. They are listed in Paragraph 8 of the parties' stipulation. A taxpayer which makes that overpayment is entitled to recover its overpayments plus interest. See in this regard Section 6611 of the Internal Revenue Code of 1954 as amended.

[p. 31] A taxpayer is also liable to the IRS for payment of interest with respect to any underpayment of income tax which had been reported by the taxpayer or later assessed by the Service. See in this regard section 6601(a) of the Code. Prior to January 1, 1987, the interest rate which was paid by the IRS on overpayments was the same interest rate which was charged to the taxpayer, should the taxpayer have made an underpayment. But the Tax Reform Act of 1986, which became effective January 1, 1987, and obviously postdated the dates in question, changed this practice and the interest rate charged on underpayments is now 1 percent higher than the interest rate paid on overpayments. Clearly suggesting the

wisdom of keeping current with the IRS, since the penalties are such that they ought [sic] weigh the fact that you can somehow pull even by paying up with them.

This so-called interest rate differential however becomes important in this case because when the plaintiff paid its taxes for tax years 1980 through '84, there were underpayments in some years, overpayments in others. Always with an overlay of a surplus. The plaintiff overstated its taxes due in tax years 1980, '81, and '82, and understated its correct tax liability computation for tax years '83 and 4. Subsequently it was calculated that the plaintiff did underpay for tax year '80, because it received excessive tax refunds. Now, all parties admit that the total of the [p. 32] plaintiff's overpayments for '81 and '82 are greater than the totaled underpayments for '80, '83, and '84.

The plaintiff NSP argues that it is entitled to have the interest on its overpayments for '81 and '82 applied and offset against the accrued interest penalties for '80, '83, and '84. In short, the plaintiff argues that the overpayments should be applied to one, or should be a applied to eliminate the imposition of deficiency interest imposed at the one percent higher rate with respect to underpayments for 1980, '83, and '84.

The Service here responds that it is not required to offset the overpayments against the previously existing tax underpayments for '80, '83, and '84. The Service further argues that the plaintiff is liable for the one year, for the one percent higher deficit, ah, deficiency interest commencing January 1, 1987, until the dates of payment

of the disputed tax and interest which finally took place in 1990.

Finally, and least persuasive, the Service argues, laughably, that it cannot over, net its overpayments, because its computers are not up to the task. The Court finds that the plaintiff's argument is far and away the more compelling. When Congress passed the Tax Reform Act of 1986, it expressed specific concern about potential unfairness to taxpayers, which had an overpayment in one [p. 33] year and an underpayment in another, and the service did not credit or net the overpayment against an underpayment to avoid the imposition of the one percent deficiency interest. See the stipulation of the parties at Exhibits C, D, and F.

The legislative history which accompanies that Act is explicit in providing that the Service should adopt and implement computerized netting procedures. The Service in 12 years has entirely failed to do so. Computer improvements would eliminate the unfairness that a plaintiff is facing in this case, namely the application of a one percent interest rate differential when the taxpayer had both overpayments and underpayments in successive tax years.

Here the Service now argues that the plaintiff cannot raise its netting argument, because that argument was not raised with specificity when the plaintiff filed its claim for tax refund as required by Treasury Regulation 301.6402-2(b)(1). The Service proffers that it may rely on this variance defense in this tax refund suit. Ironically, the variance defense is clear and can be waived by the Service if it has sufficient knowledge of a particular ground

which a taxpayer asserts for a refund, and the Service does make a determination on the merits. Here I cite only the United States Supreme Court in *Angelus Milling* [p. 34] *v. Commissioner of Internal Revenue Service* at 325 U.S. 293, 1945. The Court finds that if there were a variance, that variance defense has long been waived by the Service, since the Service had full knowledge of the plaintiff's netting claim, fully briefed the issue, and in fact has tossed this to the Court because it will not deal with it itself. The Court has reviewed *Brandt & Brandt Printers v. United States*, that's 300 F.2d 457, Ct. Cl. 1962, at citation by the plaintiff, and the court there labeled the Service's efforts to deny a taxpayer interest on its claimed refund as treading, quote, nearer to the border of dumbness than we think that they can ever approach, close quote. There's an internal reference to the Service there. The Court now does not comment whether the service has gone even closer than in Brandt & Brandt, but the low expectations suggested there have at least been equaled.

The Court grants easily the plaintiff's motion for summary judgment. NSP is full [sic] entitled to have the interest on its tax refunds for 1980 through 1984 computed by netting the 1981 and '82 overpayments against the '80, '83, and '84 underpayments.

The parties are ordered and directed to submit the proper interest calculations for payment to the plaintiff not later than December 2, 1994, and I am very sorry that the Service could not resolve this itself. You get yourself [p. 35] in a very bad position when you start to think you are the eternal arbiter of truth and any chink in your wall means that the end of the republic is at hand.

That's the order of the Court.

(Recess.)

CERTIFIED BY: _____
Dawn M. Sampson

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
FOURTH DIVISION
4-92-CV-74

Northern States Power Company	)	
	)	ORDER
v.	)	
	)	(Filed
United States of America	)	Nov. 22, 1994)
	)	

This matter is before the Court on cross motions for summary judgment, pursuant to Rule 56(c) of the Federal Rules of Civil Procedure. The Court heard oral argument on November 18, 1994. For the reasons set forth at the hearing, and based on the files, records, and proceedings herein, IT IS ORDERED that:

1. Plaintiff's motion for summary judgment is granted.

2. Defendant's motion for summary judgment is denied.

LET JUDGMENT BE ENTERED ACCORDINGLY.

Dated: November 22nd, 1994

/s/ James M. Rosenbaum
JAMES M. ROSENBAUM
United States District Judge

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 95-1306MNMI

Northern States Power Company, et al,	*	
Appellees,	*	Order Denying Petition for Rehearing and Suggestion for Rehearing En Banc
v.	*	
United States of America,	*	
Appellant.	*	

The suggestion for rehearing en banc is denied. The petition for rehearing by the panel is also denied.

Judge Loken took no part in the consideration or decision of this case.

April 5, 1996

Order Entered at the Direction of the Court:
/s/ Michael E. Gans
Clerk, U.S. Court of Appeals, Eighth Circuit

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MINNESOTA
FOURTH DIVISION

NORTHERN STATES POWER COMPANY, a Minnesota corporation,
and
NORTHERN STATES POWER COMPANY, a Wisconsin corporation,

Plaintiffs,

vs.

UNITED STATES OF AMERICA,

Defendant.

Civil File No. 4-92 Civil 74

JUDGMENT

The cross-motions of the parties for summary judgment having come on for hearing before the Court on November 18, 1994, and the issues having been duly heard and the Court having previously issued its orders dated November 18, 1994 and November 22, 1994,

IT IS HEREBY FURTHER ORDERED AND ADJUDGED THAT:

1. The defendant shall pay to the plaintiffs refunds of income tax and interest for taxable years 1980 through 1984 in the amounts set forth below, together with interest on each such amount pursuant to Sections 6611 and 6621 of the Internal Revenue Code from December 1, 1994

until such refunds are duly scheduled and processed for payment:

a. For taxable year 1980, the sum of $11,682,449.85, plus interest;

b. For taxable year 1981, the sum of $2,026,883.16, plus interest;

c. For taxable year 1982, the sum of $16,473.94, plus interest;

d. For taxable year 1983, the sum of $3,345,163.51, plus interest; and

e. For taxable year 1984, the sum of $12,629,728.95, plus interest.

2. The plaintiffs, as the prevailing party, are entitled to an award of their costs against the defendant as provided by law;

3. In all other respects, the settlement agreement previously entered into between the parties shall govern their rights and obligations and such settlement agreement shall be unaffected by the Court's orders and judgments issued in connection with the instant cross-motions for summary judgment.

Approved: This 2nd day of December, 1994

/s/ James M. Rosenbaum
James M. Rosenbaum
United States District Judge

Entered: This _____ day of December, 1994

/s/ _____
Clerk of Court

STATUTES INVOLVED

Internal Revenue Code of 1986

26 U.S.C. § 6402. Authority to make credits or refunds

(a) General rule. In the case of any overpayment, the Secretary, within the applicable period of limitations, may credit the amount of such overpayment, including any interest allowed thereon, against any liability in respect of an internal revenue tax on the part of the person who made the overpayment and shall, subject to subsections (c) and (d), refund any balance to such person.

26 U.S.C. § 6601

(f) Satisfaction by credits. If any portion of a tax is satisfied by credit of an overpayment, then no interest shall be imposed under this section on the portion of the tax so satisfied for any period during which, if the credit had not been made, interest would have been allowable with respect to such overpayment.

26 U.S.C. § 6621. Determination of rate of interest

(a) General rule.

(1) Overpayment rate. The overpayment rate established under this section shall be the sum of –

(A) the Federal short-term rate determined under subsection (b), plus

(B) 2 percentage points.

To the extent that an overpayment of tax by a corporation for any taxable period (as defined in subsection (c)(3)) exceeds $10,000, subparagraph (B) shall be applied by substituting "0.5 percentage point" for "2 percentage points".

(2) Underpayment rate. The underpayment rate established under this section shall be the sum of –

(A) the Federal short-term rate determined under subsection (b), plus

(B) 3 percentage points.

(b) Federal short-term rate. For purposes of this section –

(1) General rule. The Secretary shall determine the Federal short-term rate for the first month in each calendar quarter.

(2) Period during which rate applies.

(A) In general. Except as provided in subparagraph (B), the Federal short-term rate determined under paragraph (1) for any month shall apply during the first calendar quarter beginning after such month.

(B) Special rule for individual estimated tax. In determining the addition to tax under section 6654 for failure to pay estimated tax for any taxable year, the Federal short-term rate which applies during the 3rd month following such taxable year shall also apply during the first 15 days of the 4th month following such taxable year.

(3) Federal short-term rate. The federal short-term rate for any month shall be the Federal short-term rate determined during such month by the Secretary in accordance with section 1274(d). Any such rate shall be rounded to the nearest full percent (or, if a

multiple of 1/2 of 1 percent, such rate shall be increased to the next highest full percent).

(c) Increase in underpayment rate for large corporate underpayments.

(1) In general. For purposes of determining the amount of interest payable under section 6601 on any large corporate underpayment for periods after the applicable date, paragraph (2) of subsection (a) shall be applied by substituting "5 percentage points" for "3 percentage points".

(2) Applicable date. For purposes of this subsection –

(A) In general. The applicable date is the 30th day after the earlier of

(i) the date on which the 1st letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals is sent, or

(ii) the date on which the deficiency notice under section 6212 is sent.

(B) Special rules.

(i) Nondeficiency procedures. In the case of any underpayment of any tax imposed by this subtitle to which the deficiency procedures do not apply, subparagraph (A) shall be applied by taking into account any letter or notice provided by the Secretary which notifies the taxpayer of the assessment or proposed assessment of the tax.

(ii) Exception where amounts paid in full. For purposes of subparagraph (A), a letter of notice shall be disregarded if, during the 30-day period beginning on the day on which it was sent, the taxpayer makes a payment equal to the amount shown as due in such letter or notice, as the case may be.

(3) Large corporate underpayment. For purposes of this subsection

(A) In general. The term "large corporate underpayment" means any underpayment of a tax by a C corporation for any taxable period if the amount of such underpayment for such period exceed $100,000.

(B) Taxable period. For purposes of subparagraph (A), the term "taxable period" means

(i) in the case of any tax imposed by subtitle A, the taxable year, or

(ii) in the case of any other tax, the period to which the underpayment relates.

Tax Reform Act of 1986

SEC. 1511. DIFFERENTIAL INTEREST RATE.

(A) GENERAL RULE. Section 6621 (relating to determination of rate of interest) is amended by striking out subsections (a), (b), and (c) and inserting in lieu thereof the following:

"(a) GENERAL RULE.

"(1) OVERPAYMENT RATE. The overpayment rate established under this section shall be the sum of

"(A) the short-term Federal rate determined under subsection (b), plus

"(B) 2 percentage points.

"(2) UNDERPAYMENT RATE. The underpayment rate established under this section shall be the sum of

"(A) the short-term Federal rate determined under subsection (b) plus

"(B) 3 percentage points.

"(b) SHORT-TERM FEDERAL RATE. For purposes of this section

"(1) GENERAL RULE. The secretary shall determine the short-term federal rate for the first month in each calendar quarter.

"(2) PERIOD DURING WHICH RATE APPLIES.

"(a) IN GENERAL. Except as provided in subparagraph (B), the Federal short-term rate determined under paragraph (1) for any month shall apply during the first calendar quarter beginning after such month.

"(B) SPECIAL RULE FOR INDIVIDUAL ESTIMATED TAX. In determining the addition to tax under section 6654 for failure to pay estimated tax for any taxable year, the Federal short-term rate which applies during the 3rd month following such taxable year shall also apply during the first 15 days

of the 4th month following such taxable year.

"(3) FEDERAL SHORT-TERM RATE. The Federal short-term rate for any month shall be the Federal short-term rate determined during such month by the Secretary in accordance with section 1274(d). Any such rate shall be rounded to the nearest full percent (or, if a multiple of 1/2 of 1 percent, such rate shall be increased to the next highest full percent)."

(b) COORDINATION BY REGULATION. The Secretary of the Treasury or his delegate may issue regulations to coordinate section 6621 of the Internal Revenue Code of 1954 (as amended by this section) with section 6601(f) of such Code. Such regulations shall not apply to any period after the date 3 years after the date of the enactment of this Act.

Omnibus Budget Reconciliation Act of 1990

SEC. 11341 INCREASE IN RATE OF INTEREST PAYABLE ON LARGE CORPORATE UNDERPAYMENTS.

(a) General Rule. Section 6621 (relating to determination of rate of interest) is amended by adding at the end thereof the following new subsection:

"(c) INCREASE IN UNDERPAYMENT RATE FOR LARGE CORPORATE UNDERPAYMENTS.

"(1) IN GENERAL. For purposes of determining the amount of interest payable under section 6601 on any large corporate underpayment for periods after the

applicable date, paragraph (2) of subsection (a) shall be applied by substituting '5 percentage points' for '3 percentage points'.

"(2) APPLICABLE DATE. For purposes of this subsection

"(A) IN GENERAL. The applicable date is the 30th day after the earlier of

"(i) the date on which the 1st letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals is sent, or

"(ii) the date on which the deficiency notice under section 6212 is sent.

"(B) SPECIAL RULES.

"(i) NONDEFICIENCY PROCEDURES. In the case of any underpayment of any tax imposed by this subtitle to which the deficiency procedures do not apply, subparagraph (A) shall be applied by taking into account any letter or notice provided by the Secretary which notified the taxpayer of the assessment or proposed assessment of the tax.

"(ii) EXCEPTION WHERE AMOUNTS PAID IN FULL. For purposes of subparagraph (A), letter or notice shall be disregarded

if, during the 30-day period beginning on the day on which it was sent, the taxpayer makes a payment equal to the amount shown as due in such letter or notice as the case may be.

"(3) LARGE CORPORATE UNDERPAYMENT. For purposes of this subsection

"(A) IN GENERAL. The term 'large corporate underpayment' means any underpayment of a tax by a C corporation for any taxable period if the amount of such underpayment for such period exceeds $100,000.

"(B) TAXABLE PERIOD. For purposes of subparagraph (A), the term 'taxable period' means

"(i) In the case of any tax imposed by subtitle A, the taxable year, or

"(ii) in the case of any other tax, the period to which the underpayment relates."

(b) EFFECTIVE DATE. The amendment made by subsection (a) shall apply for purposes of determining interest for periods after December 31, 1990.

Uruguay Round Agreements Act

SEC. 713. REDUCTION IN RATE OF INTEREST PAID ON CERTAIN CORPORATE OVERPAYMENTS.

(a) IN GENERAL. Paragraph (1) of section 6621(a) (defining overpayment rate) is amended by adding at the end the following new flush sentence:

"To the extent that an overpayment of tax by a corporation for any taxable period (as defined in subsection (c)(3)) exceeds $10,000, subparagraph (B) shall be applied by substituting '0.5 percentage point' for '2 percentage points'."

(b) EFFECTIVE DATE. The amendment made by this Section shall apply for purposes of determining interest for periods after December 31, 1994.

Supreme Court, U.S.
FILED
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No. 96-29

In the Supreme Court of the United States

OCTOBER TERM, 1995

NORTHERN STATES POWER COMPANY, ET AL.,
PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether the amount of interest to be paid on petitioners' income tax refunds in this suit involving several taxable years should be calculated by "netting" petitioners' underpayments of income tax for 1980, 1983, and 1984 against their overpayments of income tax for 1981 and 1982, even though the underpayments had been paid in full and thus did not exist at the time the overpayments were determined.

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NORTHERN STATES POWER COMPANY, ET AL.,
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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-14) is reported at 73 F.3d 764. The opinion of the district court (Pet. App. 15-21) is not reported.

JURISDICTION

The judgment of the court of appeals was entered on January 2, 1996. A petition for rehearing with suggestion for rehearing en banc was denied on April 5, 1996 (Pet. App. 23). The petition for a writ of certiorari was filed on July 5, 1996. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. In 1990, the Internal Revenue Service disallowed various deductions claimed by petitioners on their income tax returns for 1980, 1981, 1983, and 1984. The IRS assessed tax deficiencies against petitioners for those years. Petitioners paid the deficiencies which, together with interest, aggregated $23,630,893. Petitioners then filed administrative claims for refund for those years and also filed amended returns for certain years (1981, 1982, and 1984), asserting an entitlement to additional refunds for previously unclaimed tax credits. When these administrative refund claims were not granted, petitioners commenced this refund suit in district court (Pet. App. 2).

In 1994, the parties settled the disputed substantive tax issues and stipulated that petitioners' income tax liabilities for 1980, 1983, and 1984 were greater than the amounts that they had reported and that their liabilities for the years 1981 and 1982 were less than reported. Because the agreed deficiencies for 1980, 1983, and 1984 were smaller than the deficiencies originally determined by the IRS (which petitioners had paid in 1990), the parties agreed that petitioners had overpaid their tax for those years and were entitled to refunds of tax plus interest for each of those years. The parties were unable, however, to agree on the correct manner of calculating the interest payable on the refunds. That calculation had financial importance because, after January 1, 1987, underpayments of tax bear interest at a higher rate than overpayments (Pet. App. 2-3). See 26 U.S.C. 6601(a), 6611(a), 6621(a).

Petitioners took the position that they were entitled to credit or "net" their overpayments for 1981 and 1982 against their underpayments for 1980, 1983, and 1984 as of the dates the underpayments arose. Since the total amount of the overpayments for 1981 and 1982 exceeded the total amount of the underpayments for the other three years, petitioners contended that no interest should accrue on the underpayments at the higher underpayment rate. The government disagreed with petitioners' proposed method of netting underpayments and overpayments, contending that the interest due on overpayments—and owed on underpayments—should be calculated separately for each taxable year in issue (Pet. App. 3-4). As of November 30, 1994, the amount of interest due to petitioners under their method of calculation was approximately $460,000 more than the amount calculated under the government's method (Pet. App. 3 n.3).

2. The district court ruled in petitioners' favor (Pet. App. 15-21). The court concluded that the legislative history of Section 1511(b) of the Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2744, indicates that the government is to "net" overpayments and underpayments in the manner that petitioners sought (Pet. App. 19). The court held that petitioners are "entitled to have the interest on [their] tax refunds for 1980 through 1984 computed by netting the 1981 and '82 overpayments against the '80, '83, and '84 underpayments" (Pet. App. 20) and entered judgment accordingly (Pet. App. 22, 24-25).

3. The court of appeals reversed (Pet. App. 1-14). Focussing on the language of the governing statutes, the court held that the amount of interest to be paid on petitioners' income tax refunds for the tax years

1980 through 1984 should not be calculated by "netting" the overpayments of tax against underpayments that did not exist (because they had previously been paid) at the time the overpayments arose. The court concluded that the text of the applicable statutes disposes of this case (Pet. App. 5-7, 11) for, (i) as a general rule, interest is calculated separately on overpayments and underpayments of tax (26 U.S.C. 6601(a), 6611(a), (b)) and, (ii) as an exception to that general rule, an underpayment is to be "netted" against an overpayment in calculating the amount of interest due only when the underpayment is satisfied by a "credit" of the overpayment (26 U.S.C 6601(f)). The court noted that the IRS has discretionary authority to refund a tax overpayment or instead to credit it against a tax liability (26 U.S.C. 6402(a)) and that a tax overpayment can be credited against a tax liability only when that liability is unpaid and outstanding at the time the credit is to be made (Pet. App. 7-8). Because the underpayments involved in this case were fully paid in 1990—and therefore did not exist in 1994 when the existence of the overpayments was determined—the IRS never credited (and, indeed, could not possibly have credited) petitioners' overpayments against their underpayments. As the result, the netting rules of Section 6601(f) of the Code were not applicable, or available, in this case (Pet. App. 11):

> [T]he IRS may credit an overpayment against an outstanding liability, and, if it does, Section 6601(f)'s netting provision comes into play. In this case, however, not only has the IRS apparently chosen not to credit the overpayments, there were

no outstanding liabilities against which the overpayments might be credited.

The court rejected petitioners' reliance upon the decision of the Seventh Circuit in *Pettibone Corp.* v. *United States*, 34 F.3d 536 (1994). The court explained that the decision in *Pettibone* "has little to do with this case" (Pet. App. 13) because, unlike the situation here, "netting" occurred in *Pettibone* when unpaid, outstanding tax deficiencies were satisfied by crediting overpayments against them (*ibid.*).

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore not warranted.

1. a. In general, the taxpayer must pay interest on the amount of any underpayment from the date prescribed for payment until the date the tax is paid. 26 U.S.C. 6601(a). When an overpayment occurs, the government is also to pay interest on the amount overpaid from the date of the overpayment. 26 U.S.C. 6611(a). The IRS is permitted, in its discretion, to credit the amount of an overpayment (including the interest allowed thereon) against any unpaid liability for an internal revenue tax of the person who made the overpayment. 26 U.S.C. 6402(a). When any part of a taxpayer's liability is satisfied by the credit of an overpayment, no interest is imposed on the portion of the underpayment thus satisfied for the period during which interest would have been allowable on the overpayment if the credit had not been made. 26 U.S.C. 6601(f), 6611(b)(1). Section 6601(f) of the Internal Revenue Code expressly provides (26 U.S.C. 6601(f) (emphasis added)):

> *If any portion of a tax is satisfied by credit of an overpayment, then no interest shall be imposed* under this section *on the portion of the tax so satisfied* for any period during which, if the credit had not been made, interest would have been allowable with respect to such overpayment.

Prior to January 1, 1987, when interest accrued on underpayments and overpayments of tax at the same rate, it ordinarily made no difference whether an underpayment was satisfied by credit of an overpayment (with the result that no interest would be deemed to have accrued for the period during which both the underpayment and overpayment existed) or whether interest was permitted to accrue simultaneously on both. After January 1, 1987, however, the rate of interest that taxpayers must pay on *under*payments has been higher than the rate that the government is to pay on *over*payments. 26 U.S.C. 6621(a).[1]

b. Petitioners object to having the interest on their tax refunds calculated separately for each year in issue because, for any period after 1986 during which

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[1] In 1986, Congress amended Section 6621 of the Internal Revenue Code, 26 U.S.C. 6621, effective as of January 1, 1987, to provide that the rate of interest on underpayments, which previously had been the same as the rate on overpayments, would be one percentage point higher than the rate on overpayments. Tax Reform Act of 1986, Pub. L. No. 99-514, § 1511(a), 100 Stat. 2744. Since that time, Congress has twice amended Section 6621 to increase the spread between the rates of the interest that accrues on certain overpayments and underpayments of corporations. Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, § 11341(a), 104 Stat. 1388-471 (adding I.R.C. 6621(c)); Uruguay Round Agreements Act, Pub. L. No. 103-465, § 713(a), 108 Stat. 5001.

they had both an underpayment of tax for one year and an overpayment of tax for a different year outstanding at the same time, that method would give the government the benefit of the statutory differential in interest rates on underpayments and overpayments. See note 1, *supra*. Petitioners seek to eliminate the effect of that statutory differential by crediting any overpayments of tax that they had outstanding for some years against any underpayments that, at the same time, they had outstanding for other years. Under petitioners' theory, interest would run in their favor whenever the aggregate of their overpayments exceeded the aggregate of their underpayments (a computational method referred to as "global netting").

In 1990, however, petitioners paid in full the underpayments that existed in their income taxes for 1980, 1983, and 1984. Because those underpayments had been paid in full, none of them were (or could have been) satisfied by the credit of overpayments determined *after* 1990 for different taxable years (Pet. App. 11). As the court of appeals correctly held (*ibid.*), because petitioners' underpayments were not "satisfied by credit of an overpayment" (26 U.S.C. 6601(f)), the netting provisions of Section 6601(f) are simply not applicable.

2. Petitioners ignore the plain language of Section 6601(f) which limits netting to the situation where an underpayment is "satisfied by credit of an overpayment" (26 U.S.C. 6601(f)). They assert (Pet. 13, 20-23) that a different conclusion is supported by the text and history of Section 1511 of the Tax Reform Act of 1986 (the 1986 Act), Pub. L. No. 99-514, 100 Stat. 2744, which established the interest rate differential in Section 6621 of the Code between interest on

underpayments and interest on overpayments. See note 1, *supra*. Petitioners contend that Section 1511(b) of the 1986 Act requires netting in all cases in which a taxpayer has an underpayment for some years and an overpayment for other years (Pet. 14, 23).

The text of Section 1511(b) of the 1986 Act plainly does not mandate netting of underpayments and overpayments in all circumstances. That Section provides only that the Secretary (100 Stat. 2744):

> may issue regulations to coordinate section 6621 of the Internal Revenue Code * * * with section 6601(f) of such Code. Such regulations shall not apply to any period after the date 3 years after the date of the enactment of this Act.

Obviously, a provision that does no more than authorize the adoption of temporary regulations—having an effective life no longer than 3 years—imposes no substantive requirement concerning the netting of overpayments and underpayments. As the court of appeals correctly concluded (Pet. App. 9 n.6), Section 1511(b) of the 1986 Act plainly does not impose a congressional mandate that the IRS employ global netting computations in the circumstances of this case. In particular, nothing in Section 1511(b) purports to alter the scope or operation of Section 6601(f) of the Code, which provides for netting in the calculation of interest only when an underpayment "is satisfied by credit of an overpayment" (26 U.S.C. 6601(f)).

Petitioners nonetheless seek to rely on statements in the legislative history of Section 1511 of the 1986 Act which, according to petitioners, reveal an intent of Congress to require global interest netting (Pet.

14-15, 22-23). Whether, as petitioners contend, the legislative history can be understood to reveal a preference for global netting is irrelevant—for the statute neither authorizes such netting nor imposes a requirement for it. As this Court has emphasized, "courts have no authority to enforce [a] principl[e] gleaned solely from legislative history that has no statutory reference point." *Shannon* v. *United States*, 114 S. Ct. 2419, 2426 (1994) (brackets in original), quoting *IBEW Local 474* v. *NLRB*, 814 F.2d 697, 712 (D.C. Cir. 1987). As the court of appeals correctly noted in this case, "Congress knows very well how to mandate something; it has not done so here" (Pet. App. 10).

Moreover, the legislative history on which petitioners rely does not support their position. That history does not reflect an intent to change the circumstances in which Section 6601(f) is to apply; instead, it explicitly confirms that Section 6601(f) applies only "to the extent a portion of tax due is satisfied by a credit of an overpayment." H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess., Pt. II, at 785 (1986) (quoted at Pet. 15). The committee report thus reflects a desire that the IRS implement comprehensive procedures that comply with existing statutes, rather than a desire (much less a directive) that the agency implement procedures that disregard those statutes.[2]

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[2] Petitioners also err in relying (Pet. 16-17) on subsequent committee reports (H.R. Conf. Rep. No. 964, 101st Cong., 2d. Sess. 1101 (1990); H.R. Rep. No. 826, 103d Cong., 2d Sess., Pt. I at 178 (1994)). Those reports referred to the agency's authority to credit overpayments against tax liabilities under Section 6402 and, again, explicitly recognized that, under applicable law, the netting rules of Section 6601(f) apply "[t]o the extent a portion of tax due is satisfied by a credit of an overpayment."

3. Petitioners contend that the decision of the court of appeals confers upon the IRS "unprecedented discretion to play interest arbitrage to the financial detriment of taxpayers" (Pet. 23). But the "discretion" of which petitioners complain is simply the discretion that Congress expressly provided the agency either to refund an overpayment or to credit it against an outstanding underpayment. 26 U.S.C. 6402(a). Other courts have consistently agreed that the statute has this precise purpose and effect. See *In re Ryan*, 64 F.3d 1516, 1523 (11th Cir. 1995); *Pettibone Corp.* v. *United States*, 34 F.3d 536, 538 (7th Cir. 1994); *Estate of Bender* v. *Commissioner*, 827 F.2d 884, 887 (3d Cir. 1987). Contrary to petitioners' assertion, it was thus Congress, in enacting Section 6402(a), not the decision in this case, that conferred that authority on the agency. Indeed, petitioners ultimately acknowledge that the statute itself grants discretion to the IRS to decide "whether an overpayment should be refunded to a delinquent taxpayer or applied against any delinquencies" (Pet. 28).

There is no basis for petitioners' contention that the decision in this case broadens the discretionary power that Congress expressly conferred on the agency by statute. Section 6402(a) authorizes the IRS, in its discretion, to credit overpayments against outstanding tax liabilities rather than refunding them. 26 U.S.C. 6402(a). The court correctly noted in this case that an overpayment may be "credited" *only* if an underpayment exists at the time the credit is to

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H.R. Conf. Rep. No. 964, *supra*, at 1101; H.R. Rep. No. 826, *supra*, Pt. I, at 178. Neither the committee reports nor the statutes they accompany purport to alter the application or scope of Section 6402(a) or 6601(f) of the Code.

be made (Pet. App. 7-8). See also 26 C.F.R. 301.6402-1. There was no occasion for the IRS to exercise its discretion to decide whether to credit or refund an overpayment under Section 6402(a) in this case because no "underpayments" existed at the time the overpayments were determined. The discretion that petitioners claim *could* be abused in some contexts was thus never even invoked on the facts of this case.

4. Petitioners err in contending (Pet. 26-29) that the decision in this case conflicts with the decision of the Seventh Circuit in *Pettibone Corp.* v. *United States*, 34 F.3d 536 (1994). The situation addressed in *Pettibone* is factually and legally distinct from the present case.

Pettibone involved a corporate taxpayer in bankruptcy that agreed to a Chapter 11 reorganization plan calling for full payment of its tax liabilities. 34 F.3d at 537-538. Following an audit, the IRS filed an amended proof of claim in the bankruptcy proceeding relating to 13 of the corporation's tax years. *Ibid.* Because the taxpayer had underpaid its taxes for some of the years in issue and overpaid for the others, the IRS credited the outstanding overpayments against the outstanding underpayments under Section 6402(a). The taxpayer claimed (i) that such crediting under Section 6402(a) constituted a "setoff" prohibited by the Bankruptcy Code and (ii) that interest continued to flow in its favor on the aggregate overpayments, but that the automatic bankruptcy stay precluded interest from running against it on the aggregate underpayments. 34 F.3d at 538. The court of appeals upheld the government's claim, however, concluding that "the netting of tax overpayments against underpayments" did not constitute a proscribed "setoff." *Id.* at 538-539.

The court of appeals correctly noted in this case (Pet. App. 13) that the government successfully asserted in *Pettibone* that overpayments could be credited under Section 6402(a) against tax liabilities of the taxpayer that *remained unpaid.* In the present case, by contrast, there were no outstanding underpayments of tax to credit against the overpayments at the time that the overpayments arose. The Seventh Circuit did not suggest in *Pettibone* that overpayments should—or could—be credited against former tax liabilities that had been fully paid, as petitioners contend should be required in this case. See 34 F.3d at 537. There is thus no conflict between *Pettibone* and the decision in this case.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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NORTHERN STATES POWER COMPANY,
a Wisconsin corporation,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

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BRIEF OF *AMICUS CURIAE* EDISON ELECTRIC INSTITUTE IN SUPPORT OF PETITIONER

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QUESTIONS PRESENTED

Edison Electric Institute adopts the questions presented in the Petition for Writ of *Certiorari* of Petitioner Northern States Power Company.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1996

No. 96-29

NORTHERN STATES POWER COMPANY,
a Minnesota corporation, and
NORTHERN STATES POWER COMPANY,
a Wisconsin corporation,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

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BRIEF OF *AMICUS CURIAE* EDISON ELECTRIC INSTITUTE IN SUPPORT OF PETITIONER

Amicus curiae Edison Electric Institute (EEI) respectfully prays that the Court grant the Petition of Northern States Power Company for a writ of *certiorari* to the United States Court of Appeals for the Eighth Circuit in this matter. The Acting Solicitor General has consented to EEI filing this brief *amicus curiae* in support of Petitioner. The letter giving that consent is attached hereto.

INTEREST OF *AMICUS CURIAE*

Edison Electric Institute (EEI) is the association of the United States investor-owned electric utilities and their industry associates worldwide. EEI's U.S. members serve 99 percent of all customers served by the shareholder-owned segment of the U.S. industry. As of October 1995, they generated approximately 79 percent of all the electricity generated by electric utilities, and serviced 76 percent of all ultimate customers in the nation. EEI frequently represents its U.S. members before federal agencies, courts, and Congress in matters of common concern.

The members of EEI are among the nation's largest industrial and commercial enterprises, and their annual revenues and expenses, and the capital investment necessary to generate, transmit, and distribute electricity safely and reliably, are enormous by any measure. For these reasons, EEI's members are among the largest corporate income taxpayers in the United States, both in terms of their annual gross incomes and their annual taxes paid.

The magnitude, breadth, and complexity of an investor-owned electric utility's operations virtually ensure that each year's tax return will be scrutinized closely by Internal Revenue Service audit examiners. Moreover, even a small number of changes to a utility's taxable income will have a large tax impact. As a result, the Internal Revenue Service has organized specialized examination groups that focus specifically upon the electric utility industry, thereby ensuring intense scrutiny of utility tax returns.

Given the magnitude and scope of the proposed adjustments to which they are often subject, EEI's member utilities are particularly susceptible to the

harm resulting from the type of Internal Revenue Service actions in this case. As discussed below, the extent of the harm to which its members are exposed is exacerbated by the fact that several years will usually be consumed from the time the utility's tax returns are originally filed, and then examined by the Internal Revenue Service, to the time any disagreements over proposed adjustments are resolved through negotiation or, and most especially, litigation. Because the disputed overpayments and underpayments of utilities are large, the time required to pursue such matters typically involves a number of years, and the interest rate differential has been growing (and is now quite substantial), EEI's members are among those taxpayers most exposed to and harmed by the prejudice resulting from the government's position. Through actual cases, EEI will demonstrate to the Court the magnitude of the issue as it presently affects three of its members, and thus the unfair hardship that an unfettered discretion to net subjects all EEI members, all large, "accrual" taxpayers, and other corporate taxpayers as well.

SUMMARY OF ARGUMENT

EEI will provide three case studies to illustrate some typical amounts at stake, and highlight for the Court the impact of the Government's position. The actual situations of these three member companies reflect the extent to which "interest netting" (explained *infra*) can affect all of EEI's investor-owned electric utility members, as well as other corporations and all large taxpayers, and the extent to which the discretion granted to the Internal Revenue Service under the Eighth Circuit's ruling can be exercised to their financial detriment. In this case, in fact, had Petitioner not paid the $23.6 million in disputed as-

sessments prior to the 1990 increase in underpayment interest rates (Omnibus Budget Reconciliation Act of 1990 [OBRA], P.L. 101-508, 104 Stat. 1388, codified at 26 U.S.C. § 6621[c] [3% "hot interest" differential]), and had Petitioner been subjected longer than it actually was to a new lower overpayment interest rate (Uruguay Round Agreements Act [GATT], P.L. 103-465, 108 Stat. 4809 [4½% differential]), the additional $460,000 that the government is attempting to extract from Petitioner would be several times greater. Sums so large, especially coming as they do doing the current major restructuring of the electric utility industry, cannot fail but have an adverse impact on utilities, their ratepayers, and their shareholders, as well as on the economy as a whole.

The failure of the Internal Revenue Service to perform interest netting when a taxpayer has simultaneous tax overpayments (refunds due) and underpayments (deficiencies owed) constitutes a dramatic and needless departure from the inherent fairness and economic sense underlying the Internal Revenue Code's basic "use of money" concept. Rev. Proc. 60-17, 1960-2 C.B. 942; *see* Petition at 6. As the District Court noted below (Petition, App. 15-16, 20), the Republic will surely not fall if interest is computed on the sound principle that it is owed to the one party who, in the aggregate, has been a creditor of the other. The strong concern and vehement criticism expressed by large corporate taxpayers, tax professionals, and industry associations over the Eighth Circuit's decision are testimony to the economic importance of interest calculations and to the perception that a refusal to net is fundamentally unfair, supremely harsh, and flatly contrary to the expressed will of Congress. *See* references at Petition 29-30.

Moreover, as noted in the Petition (26-29) the decision below is in direct conflict with a decision of the Seventh Circuit.

It would be unreasonable to assert that the years of underpayments in this case (and any other similar case) are distinct from or otherwise unrelated to the years of overpayments—in fact, they are so directly and necessarily related (as more fully described *infra*) that netting is required, at the least, for equitable and just administration of the tax laws. Moreover, the position of the Internal Revenue Service elevates form over substance, and actually rewards taxpayers for failing to pay disputed amounts prior to the resolution of the dispute. For all of the foregoing reasons, the decision of the Eighth Circuit should be reviewed and its erroneous views corrected, in order to prevent the government from continuing to exercise the discretion the decision below confers.

REASONS FOR GRANTING THE PETITION FOR A WRIT

I. BACKGROUND AND INTRODUCTION.

Adjustments to the returns of investor-owned utilities proposed by the Internal Revenue Service examining agents almost never involve income that the utility has clarly omitted, or items that are inherently not deductible or recoverable for tax purposes. Rather, the examination of a utility's tax returns usually involves disputes regarding the proper application of the "accrual" method of tax accounting, which all investor-owned electric utilities (as well as most industrial and other large commercial taxpayers) are required to follow in reporting their income and items of deduction. Under the accrual method, "timing" questions arise—*i.e.*, when income and deduc-

tions must (or may) be recognized for reporting purposes. The need to apply "interest netting" arises from timing-related adjustments of utility returns—in fact, whenever there are simultaneous tax underpayments and overpayments—because of the differing interest rates applicable to such underpayments and overpayments and, in the words of the district court, "the agonizing slow administrative process of the Internal Revenue Service" (Petition, App. 16).

A. Accrual Accounting Gives Rise to Timing Adjustments.

Most corporate income taxpayers of any significant size in the United States report their tax liabilities under an accrual method of accounting as permitted by Section 446(c)(2) of the Internal Revenue Code. Pursuant to Section 446(a) of the Internal Revenue Code and Treasury Regulation Section 1.446-1(c)(2), an accrual method is necessary whenever the taxpayer keeps its financial books pursuant to an accrual method or when it maintains an inventory. Without exception, all investor-owned utilities report their tax liabilities under an accrual method of tax accounting.

Under the accrual method, income is reportable for the taxable years in which "all the events" have occurred that fix the taxpayer's right to receive the income and the amount can be determined with reasonable accuracy. Treas. Reg. § 1.446-1(c)(1)(ii). Correspondingly, under an accrual method, a liability is incurred and generally deductible in the year in which "all the events" have occurred that establish the fact of the liability, the amount thereof can be determined with reasonable accuracy, and economic performance by the taxpayer with respect to the liability is deemed to have occurred. *Id.*; Treas. Reg. § 1.461-1(a)(2).

These broad principles can be stated only generally, however. In the facts and circumstances of any given case, the specific application of those tax accounting principles may be unclear and disputed, creating timing issues which carry large tax consequences for any particular group of years riding on the outcome. For example, in a series of cases, utility companies and the Internal Revenue Service argued over whether utilities must report certain revenues in the year in which the utilities had provided electricity to their customers but had not yet read their meters and billed them, or whether such revenues were reportable in the later year when the utilities had billed their customers for the electrical service in question. *Public Service Co. of New Hampshire v. Comm'r*, 78 T.C. 445 (1982); *Orange & Rockland Utilities v. Comm'r*, 86 T.C. 199 (1986).

Timing issues similarly arise on the deduction side of a taxpayer's liability. An accrual method taxpayer may, for example, find itself at odds with the tax collector over when a contract or tort liability has become fixed and when the amount of the liability has become reasonably determinable. *See* Section 461(a) of the Internal Revenue Code; Treas. Reg. § 1.461-1(a)(2); *see, e.g., Mooney Aircraft, Inc. v. U.S.*, 420 F.2d 400 (5th Cir. 1969). Other opportunities for disputes involve when a loss is sufficiently defined to permit a deduction (*see* Treas. Reg. § 1.165-1(d) and *De Nardo v. Comm'r*, 48 T.C.M. 1049 [CCH] [1984]); when newly acquired property is deemed to have been first placed "in a condition or state of readiness and availability for its assigned function" sufficient to permit the taxpayer to begin claiming depreciation (*see* Treas. Reg. §1.167[a]-

11[e]); and, whether certain items are currently deductible as business expenses or must instead be capitalized and their cost recovered for tax purposes in later years through depreciation or through sale or disposition of some asset (*see INDOPCO, Inc. v. Comm'r*, 112 S.Ct. 1039 [1993]).

B. Timing Adjustments and Interest Differentials Create Significant Netting Disputes.

By asserting that income should have been recognized and reported by a utility for an earlier period than the year for which it was reported by a utility, the Internal Revenue Service will, by definition, be asserting an underpayment for that earlier year. Concomitantly, however, that will, in almost every instance, create a corresponding overpayment for the (later) year during which the utility had originally reported the income. Conversely, if the Internal Revenue Service denies a deduction for the year claimed by the utility, and instead allows the deduction for a later year or years, the Service thereby will have automatically created both a deficiency for that earlier year, and corresponding overpayments for the later year (or years).

As can be seen, these timing adjustments create both underpayments and corresponding overpayments. And, as noted in the Petition (9-10), differing interest rates apply to overpayments and underpayments. *E.g.*, Tax Reform Act of 1986 § 1511(a), P.L. 99-514, 100 Stat. 2085 (1% differential). Therefore, given the large size of the underpayments, and the resulting overpayments, typically asserted in a utility timing adjustment, electric utility tax-related interest netting disputes can be of significant magnitude.

C. The Lengthly Process of Resolving Tax Disputes Exacerbates the Impact of the Interest Differential.

Delays are inherent in the administration of the tax system. At the outset, a utility's returns are complex and time-consuming for the Internal Revenue Service to examine. Moreover, two or more returns are usually grouped together for examination by the Internal Revenue Service. Thus, extensions of time for field examinations are routinely sought by the Internal Revenue Service and granted by utilities.

The field examination of a utility's returns is then usually followed by an agency appeal process within the Internal Revenue Service to determine the extent to which the field agents' proposed adjustments can be resolved without litigation. If this administrative process concludes with issues still outstanding, the utility may wish to challenge the government in refund or Tax Court litigation. As in Petitioner's case, a refund suit requires additional periods of time for the processing of the assessments by the Internal Revenue Service, the taxpayer's payment of the tax and assessed interest and filing of administrative claims for refund, and the opportunity for the Internal Revenue Service to either review or ignore the claims before suit becomes permitted (Internal Revenue Code § 6532[a]).

The litigation process itself often adds another two to four years to the dispute before the correct tax liabilities of the utility can be finally determined and the existence, amount, and duration of any individual tax year overpayment and underpayment can be conclusively determined. Thus, it is only years after returns are filed that the utility will even know whether it has overpayments and underpayments that

could offset each other, for interest computation purposes, through netting. *See, e.g., Houston Industries, Inc. v. U.S.*, 78 F.3d 564 (Fed. Cir. 1996), in which the trial court's decision in 1994 relating to two issues involving taxable years 1983 and 1984 entitle the utility to refunds that, with statutory interest, would presently exceed $100 million.

II. FAILURE TO APPLY INTEREST NETTING UNFAIRLY INCREASES TAX LIABILITIES AND CAN HAVE AN ENORMOUS FINANCIAL IMPACT.

EEI supports the Petitioner in seeking review of the unfounded and ill-advised result reached below. EEI submits this *amicus* brief to emphasize that (1) the government's refusal to compute interest under a netting method irrationally distorts the impact of purely timing adjustments, and (2) the magnitude of the economic distortions here at issue are so enormous that the Congress could never have intended to give the Internal Revenue Service the unbridled discretion that the Eighth Court's decision presumes. *Northern States Power Co. v. U.S.*, 73 F.3d 764 (8th Cir. 1996). The degree of unchecked discretion that the Eighth Circuit believes the Congress has conferred upon the Internal Revenue Service threatens uniformity and consistency in application of the tax laws across the country. The discretionary exercise of such raw, *ad hoc* power to deny netting is blatantly unfair to taxpayers, and provides a perverse incentive for asserting questionable timing adjustments subject to the interest differential.

Investor-owned electric utilities, being large, accrual method taxpayers, are particularly subject to the imposition of large tax deficiencies, a significant portion of which results from "timing" disputes that

offer an opportunity to create a further dispute over interest netting. Often, and as in Petitioner's case, asserted tax deficiencies are grossly erroneous and millions of dollars will be refunded to the utility—however, only after several years of costly litigation has concluded in a settlement or court ruling in the utility's favor. *See, e.g., Houston Industries, supra.* Given the magnitude of the proposed adjustments to which utilities are often subject, and the magnitude of refunds that are finally owed to them, utilities are especially susceptible to the harm resulting from the refusal of the Internal Revenue Service to compute interest on a netting basis. However, under the decision of the Eighth Circuit, and the position maintained by the government, there is no planning that a utility could undertake which would ensure protection against the government's asserted interest calculation discretion.

At the outset, EEI states that it supports Petitioner's legal arguments in support of its contention that interest netting is required by the terms of Section 6601(f) of the Internal Revenue Code and Section 1511(b) of the Tax Reform Act of 1986, as explained in the relevant legislative history attendant to those statutes, as well as the pertinent committee reports addressing the 1990 OBRA and 1994 GATT interest rate changes. Moreover, the decision below conflicts with a directly applicable case from the Seventh Circuit. *Pettibone Corp. v. U.S.*, 34 F.3d 536, 539 (7th Cir. 1994). In a nutshell, both the Eighth Circuit and the government have confused the debt collection "credit" available under Section 6402(a) of the Internal Revenue Code with the interest computation "credit" required under Code Section 6601(f)

and Section 1511(b) of the Tax Reform Act of 1986. The Section 6402(a) debt collection credit is discretionary with the Internal Revenue Service. The interest computation credit, however, is mandatory and self-executing, because it is necessary to implement the Code's "use of money" rationale (*see* Petition at 6-7).

A. The Government's Refusal to Net Unfairly and Irrationally Distorts the Impact of Purely Timing Adjustments.

For utility companies, and other large corporate income taxpayers, timing adjustments pose enormous, adverse financial consequences if interest is not computed on a netting basis. Utilities and other large taxpayers continually face timing adjustment disputes with the Internal Revenue Service. This is true because their income, expense, and tax credit items are large, the underlying facts are often complex, the accrual method rules are frequently debatable, and because the examining agents gravitate to utility industry timing issues because of the potential size of any successful adjustments. For instance, a determination by the Internal Revenue Service that $10 million of maintenance work performed on the turbine generator of a power plant should not be currently deducted as a repair expense in the year the utility incurred the obligation, but instead should be capitalized and depreciated, will generate a deficiency of approximately $3.5 million in tax, plus interest, for the year in question.

However, there will be corresponding overpayments in later years resulting from the $10 million in "previously" unclaimed additional depreciation deductions. Logically, and in fairness, these resulting over-

payments—which exist only by virtue of the determination that there had been underpayments—should be available to offset the $3.5 million underpayment for interest calculation purposes, even if the disallowance of the deduction proves correct. Under the Eighth Circuit's view, however, the utility will never obtain that result as a matter of law or right. On the one hand, if the utility disputes the adjustment, pays the $3.5 million deficiency, and then files a refund suit, it can never obtain interest netting under law, because the deficiency has been artificially determined to no longer exist. On the other hand, if it does not pay, and instead files a petition with the Tax Court challenging the proposed deficiency before the assessment is made, the Eighth Circuit would still grant the government the discretionary authority to decline netting.

If interest netting were available as the Congress intended, however, such timing adjustments would have only the result of increasing a tax liability for one year but decreasing it for one or more later years, consistent with congressional intent. In the above example, the taxpayer would then incur an economic timing cost equal only to the loss of use of the additional taxes determined to be owed for the earlier year, up until the later overpayment(s) arose and became available to offset the underpayment.

Without interest netting, though, the economic impact of a timing adjustment is grossly distorted by the government's refusal to shut off the running of the higher rate of interest even when corresponding overpayments result from the adjustment. When computational interest netting is denied, when the underpayments and overpayments are large, when

several years are consumed in the dispute resolution process before the existence and extent of the underpayment and overpayments can be conclusively established, and when the rate differential is as high as 4½% compounded daily, the financial consequences attending a pure timing adjustment become absurdly high and entirely disproportionate in terms of economic and tax policy. Surely Congress never intended such an irrational, unfair, and unjust result.

B. Refusal to Compute Interest on a Netting Basis Creates Interest Charges for Utilities That Dwarf Those Imposed Upon Petitioner in This Case.

To illustrate the application of the Eighth Circuit decision on EEI member companies and other large corporations, EEI describes below the situations of three different utilities. These actual cases demonstrate the potential real-world economic consequences of applying the deficiency rate of interest (currently 11%) to the underpayment years that are yet to be resolved, while simultaneously applying the refund rate of interest (currently 6.5%) to overpayment years that are also in the process of being resolved. Because the following three controversies are ongoing and unresolved, EEI is not authorized to specifically identify the utilities, and the descriptions represent best-estimate projections of the amount of underpayment liability and overpayments to be refunded and potential dates of resolution.

1) The first EEI member expects that claims for refund for the years 1986 through 1990 will not be resolved except through litigation. The amount of the refund in dispute is $60 million. In addition, the company expects to owe a deficiency of $19 million

for the year 1991. The projected date of resolution is November 1, 2000, which is four years from the scheduled completion date of the current Internal Revenue Service examination.

If the litigation is resolved on November 1, 2000, and the Internal Revenue Service does not net the $60 million in overpayments for the years 1986 through 1990 against the $19 million underpayment for 1991, the taxpayer will be charged an additional $9 million of interest. Without netting, the higher interest rate would apply to the $19 million for approximately eight years—from March 15, 1992, the due date of the 1991 return, until November 1, 2000. During this same eight-year period, the $60 million overpayment would earn only the lower (6½%) rate of interest. With netting, the $19 million underpayment would offset part of the overpayment, and interest would be paid, at the lower rate, on the $41 million net overpayment to be refunded.

In this situation, the government will have had the use of $41 million of the utility's money for eight years. To view the $19 million underpayment for 1991 and the $60 million of overpayments for the years 1986 through 1990 as separate unrelated debts is inconsistent with the fact that tax years are in fact interrelated. The interdependence between a corporation's individual tax years makes it inappropriate not to treat them as related for interest computation purposes. *See Pettibone Corp. v. U.S., supra,* 34 F.2d at 539.

2) The second EEI member is facing a decision of whether to compromise issues at the administrative level or bring suit. The company, which has resolved the issues for the years 1986 through 1989, is due

refunds for these four years of $7 million. Tax deficiencies of $22 million are projected for the years 1990 and 1991. Up to the due dates of the 1990 and 1991 returns, the overpayments for the tax years 1986 through 1989 have earned interest of approximately $2 million, which makes a total amount of $9 million of tax and interest available to offset the $22 million owed for the later years.

If the company and the Internal Revenue Service could reach a resolution today, the difference between netting and non-netting is $800,000. If the company and the Internal Revenue Service cannot reach an administrative resolution and the litigation process takes four years, however, the difference between netting and non-netting is $4 million. In making a decision on whether to compromise or litigate, the company must not only evaluate the merits of its position under the tax law, but must also consider the unknown factor of whether the Internal Revenue Service will exercise its purported "discretion" to apply interest netting. Clearly, however, under the Eighth Circuit decision, the government does not have much incentive to exercise any such discretion and apply netting.

3) The third EEI member has already been in litigation for a protracted period. The case has proceeded to the point where it is now known that the aggregate overpayment over three years, exclusive of interest, is approximately $65 million, which far exceeds the remaining potential tax that is still to be resolved for a single later year—a possible underpayment of $25 million. If, for example, in July 1997 it is finally determined that the company owes the $25 million, the difference in the interest computation be-

tween netting and non-netting will be more than $11 million.

This company has no satisfactory path to choose. Under the ruling below, the Internal Revenue Service will have the only significant choice: will it charge the underpayment rate of interest on the $25 million deficiency from the return's due date to the date of payment by the utility (a span of more than 10 years), but pay the overpayment rate of interest on the far larger overpayments, or will it net the two amounts and pay only the overpayment rate for the remaining refund due? Under the Eighth Circuit's decision, the decision whether to impose an additional $11 million charge upon the utility by simply refusing to net the overpayments against the underpayment is entirely at the discretion of the Internal Revenue Service. Again, the government does not have much incentive to exercise its discretion and apply netting.

CONCLUSION

WHEREFORE, Edison Electric Institute prays that the Court grant Northern States Power Company's Petition for a Writ of *Certiorari* to the United States Court of Appeals for the Eighth Circuit in this matter.

Respectfully submitted,

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In The

Supreme Court of the United States

October Term, 1995

NORTHERN STATES POWER COMPANY,
a Minnesota corporation, and
NORTHERN STATES POWER COMPANY,
a Wisconsin corporation,

Petitioners,

vs.

UNITED STATES OF AMERICA,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Eighth Circuit

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INTRODUCTION

The government's opposition to NSP's petition does not dispute that the netting conflict between taxpayers and the IRS is a question of such immense impact that, like the alternative minimum tax issue reviewed in *U.S. v. Hill*, 113 S. Ct. 941, 945 (1993), the "importance . . . to the federal fisc" alone merits certiorari. The government apparently concedes that the sums at stake for taxpayers nationwide and the Treasury are enormous.

The government's opposition also does not dispute either that the Internal Revenue Code embraces the "use of money" concept as the overriding principle governing interest obligations or that the objective of this principle is "to determine in a given situation whose money [has been used] and for how long the other party had the use of it." Rev. Proc. 60-17, § 2.01(1), 1960-2 C.B. 942. Likewise, the government never contests that interest netting is an accounting method which applies the "use of money" concept with mathematical exactitude and complete economic rationality.

Rather, the government's opposition rests entirely on the argument that the Eighth Circuit's statutory construction is analytically correct. However, the government assumes without foundation that the interest netting "credit" referenced in § 6601(f) must be restricted in its scope to the debt collection "credit" referenced in § 6402(a). In blithely assuming that the netting "credit" of § 6601(f) simply mirrors the debt collection "credit" of § 6402(a), the government misconstrues these statutes and ignores their respective purposes and functions. Contrary to the government's assumption, Congress' purpose

in enacting § 6601(f) in 1958 was to implement the "use of money" principle by requiring netting to alleviate any interest obligation disparities whenever a taxpayer had simultaneous overpayments and underpayments. Section 6601(f) uses the word "credit" in the broad accounting sense of an entry which is made solely to offset a liability which would otherwise exist but for the "credit."

Because their analysis goes no further than to assume that Congress' use of the word "credit" in § 6601(f) references only a § 6402(a) credit, both the government and the Eighth Circuit have disavowed any consideration of the reasons why each statute was adopted, the essential purposes which each was intended to serve, and how each fits within the Code to foster those purposes. Consequently, the government and the Eighth Circuit overlook the absurdities and anomalies which result from their interpretation of these statutes because, no matter how serious or harsh these results may be, they are purportedly compelled by the cold language of the statutory words. Reading the statutory words in a complete vacuum has led the government to argue, and the Eighth Circuit to agree, that Congress has not only failed to legislate against the identifiable harm suffered by taxpayers, but, indeed, that Congress has expressly granted the IRS broad discretion either to harm every taxpayer or, alternatively, to spare some while afflicting others. The merits of the parties' respective arguments aside, this Court should review the decision below to clarify whether tax statutes can ever be read for their assumed "plain meaning" without making any inquiry into statutory purpose or legislative intent.

Lastly, the government has embraced the Eighth Circuit's erroneous interpretation of the Seventh Circuit's decision in *Pettibone* in an effort to avoid the conflict with that decision. NSP takes this opportunity to further explain why an irreconcilable conflict is inherent in the two decisions.

DISCUSSION

I. The Government's "Plain Meaning" Construction Rests Upon an Unexplained, Unfounded, and Erroneous Assumption.

The government's first ground for opposing certiorari is that the Eighth Circuit correctly held that (1) interest netting under § 6601(f) can never be triggered unless the IRS collects a currently "outstanding" debt by means of a § 6402(a) collection setoff and (2) interest netting under § 6601(f) is never mandatory or self-executing but is, instead, wholly discretionary with the IRS because § 6402(a) is facially discretionary. This aspect of the government's opposition not only begs the question of whether the words of the Code can ever be read only with regard to what the reader *believes* some dictionary definition to require, but it is also grounded upon a demonstrably false premise.

The false premise is the government's attempt, entirely without explanation, to equate the meaning of the word "credit" as used in § 6402(a) with the meaning of the word "credit" as used in § 6601(f). The government's analysis begins with observing that § 6402(a) and Treas. Reg. § 301.6402-1 permit the IRS to "credit" an

overpayment against an underpayment. Next, the government notes that § 6601(f)'s interest netting provisions apply when the "credit" of an overpayment satisfies an underpayment. The government then assumes and declares that the "credit" referenced in § 6601(f) can only mean the debt collection "credit" referenced in § 6402(a) and Treas. Reg. § 301.6402-1. The government's premise is, however, neither analytically nor historically correct.

First, the word "credit" as used in the Code has different meanings, depending upon the context and purpose for which it is being used. In the § 6402(a) context of the collection of a still unpaid and "outstanding" debt, the word "credit" means the bookkeeping entry that the IRS makes on its internal taxpayer accounts when it *transfers funds* from one tax liability account which is overpaid to another liability account which is underpaid. For debt collection purposes, the § 6402(a) "credit" references only this internal, administrative transfer of funds.

The word "credit," however, is used throughout the Code with a far broader meaning than the "collection" transfer crediting exercise in § 6402(a). For tax law and tax accounting purposes, the word "credit" also means *any* accounting or bookkeeping entry that reduces or offsets a liability that would otherwise be owed, but for the "credit." For example, a taxpayer may be entitled to an investment tax credit or a research tax credit, each of which is a "credit" that satisfies or reduces an otherwise owed tax liability. *See* §§ 46 and 41(a) of the Code. Unlike a "collection"-type credit, these "credits" do not represent funds which are physically transferred from the

taxpayer to the IRS or from one IRS account to another. They exist solely as an "on paper" accounting or bookkeeping entry on a taxpayer's return. They are accounting credits which are purely computational reductions of a liability.

Similarly, in the context of interest computations, the word "credit" in § 6601(f) is simply a reference to any overpayment which offsets an underpayment for the purpose of determining which party had the use of how much of the other party's money and for how long. This is so because interest netting is purely an *accounting method* for purposes of combining multiple tax liability accounts into one aggregate, combined, and chronological account, with interest owed, to one party or the other, only on the net running balance. *Pettibone Corp. v. U.S.*, 34 F.3d 536, 538-39 (7th Cir. 1994). In short, interest netting is merely the accounting method used to implement a "use of money" calculation. No transfer of funds between accounts is necessary. For such reason, the "credit" which triggers § 6601(f) interest netting is any overpayment which simultaneously existed at the time of any underpayment. Whether the underpayment is later paid or remains still "outstanding" for collection purposes at the time the interest computation is being made is irrelevant to whether an overpayment and underpayment had simultaneously existed in the past for interest obligation purposes.

Second, the respective histories underlying §§ 6402(a) and 6601(f) demonstrate that § 6601(f) is not merely a captive of debt collection setoffs. The IRS has performed debt collection setoffs under § 6402(a) and its predecessor statutes since the 1930s, long before 1958 when Congress

first enacted interest netting in § 6601(f). When Congress enacted § 6601(f), its purpose had nothing whatever to do with § 6402(a) debt collection setoffs. Rather, in enacting § 6601(f), Congress sought to implement strict "use of money" crediting concepts into all interest computations.

As the pre-1958 cases cited in the petition reflect, in enacting § 6601(f) Congress was concerned with curing the anomalous departures from the "use of money" concept that had arisen in such cases as when taxpayers had simultaneously overpaid and underpaid certain types of tax obligations or when taxpayers were receiving interest on an overpayment of one tax liability for a period of time during which the IRS was prohibited from collecting interest on an underpayment of another tax liability. (Petition at 9). None of the circumstances which necessitated § 6601(f) involved a § 6402(a) debt collection offset. Each of the cases cited was a refund suit, like NSP's, in which all amounts had been fully paid as required before the refund suit could be brought. No "outstanding" underpayment remained owing at the time of suit. In no case was the fact of full payment, and the resulting inability of the IRS to collect an "outstanding" liability by means of an administrative setoff, treated as in any way relevant to, let alone determinative of, whether or not interest should be computed with netting.

Only by a wholesale disregard for the purpose of § 6601(f) and a refusal to engage in the type of analysis required by this Court in the cases such as *Bob Jones University v. U.S.*, 416 U.S. 574, 586 (1983), and *U.S. v. Goodyear Tire and Rubber Co.*, 493 U.S. 132, 139-40 (1989), can the government assert that netting is restricted to

discretionary debt collection setoffs. Interest netting has existed independently of § 6402(a) since 1958 and was already required by law long before Congress adopted differential rates in 1986. In § 1511(b), Congress simply took steps to make clear to the IRS that the implementation of comprehensive netting was essential under the newly instituted differential rate system.

II. The Government Has Failed to Address the Conceptual Conflict Between the Eighth Circuit and Seventh Circuit.

The government's effort to gloss over the conflict between the Eighth Circuit and the Seventh Circuit in *Pettibone* by arguing that all the IRS had attempted to do in *Pettibone* was to collect the "outstanding" individual tax year underpayments is an extension of its erroneous approach of treating collection credits and interest netting credits as one and the same.

In *Pettibone*, if interest on each of the 13 individual tax year underpayments and overpayments involved in the case had been computed separately as of the time of trial, the government would have *owed* the taxpayer more than $250,000. Therefore, even had the IRS been permitted to engage in simple debt collection setoffs under § 6402(a) at the time of trial, that would have yielded a net *refund* to the taxpayer because the IRS would not have been able to charge interest on the underpayments after the date of the bankruptcy petition and until the plan was confirmed.

Instead, in *Pettibone* the government argued for retrospectively combining each of the 13 separate tax year

accounts into one aggregate account which began with the filing of the return for the first of the 13 years and ran forward to the bankruptcy litigation. The government argued that the theory underlying § 6601(f) netting is that overpayments and underpayments cancel themselves out for interest computation purposes "for the period during which such obligations are mutually offsetting." (Petition at 8). Lending full support to NSP's contention that a "credit" for § 6601(f) purposes means an accounting "credit" entry for computing interest, the government in *Pettibone* characterized netting as an accounting method in which an overpayment is a "credit" against an underpayment for interest purposes. The Seventh Circuit agreed and never treated interest netting as merely the consequence of debt collection.

That the government performed, and the Seventh Circuit embraced, interest netting and not debt collection is further confirmed by the methodology employed by the IRS in *Pettibone*. There, the government's interest computation specialist retrospectively combined the 13 separate year accounts into one aggregate account in which each overpayment and underpayment was chronologically applied in the precise historical sequence in which each actually arose. Interest was then applied only to the aggregate net overpayment or net underpayment running balance over the entire history of this single account. This constitutes interest netting, the benefit of which NSP has sought in this case. On the other hand, under raw § 6402(a) debt collection authority, the IRS could have applied *any* overpayment against *any* underpayment in *any* sequence it might have chosen. In *Pettibone*, the IRS did not perform discretionary debt

collection and the Seventh Circuit never characterized the netting exercise as the collection of any "outstanding" debt. In fact, in *Pettibone* the only dispute related to the methodology for computing interest because the parties had fully stipulated individual year tax overpayment and underpayment amounts. *See also* the discussion of the government's interest netting method and its reliance upon § 6601(f) in *In Re Pettibone Corp.*, 161 B.R. 960, 962 (N.D. Ill. 1993). Limiting interest netting to a simple by-product of debt collection under § 6402(a), as the Eighth Circuit has done, is flatly irreconcilable with the Seventh Circuit's decision in *Pettibone*.

CONCLUSION

Congress has acted far more intelligently, rationally, and beneficently than the government and the Eighth Circuit would have it. Since 1958, Congress has legislated fair "use of money" interest netting concepts, unadulterated by IRS discretion, into the interest obligation provisions of the tax law. In 1986, Congress enacted § 1511(b) to insure that the IRS would take the steps necessary to comprehensively implement this already-required netting principle in the context of the differential rate structure then being adopted in § 1511(a) for the first time. In 1990 and 1994, Congress reiterated the need for comprehensive netting, aware as it was on each of those occasions of the IRS' wholesale noncompliance. Only by divorcing themselves from the principles which must guide the statutory analysis have the government and the Eighth Circuit reached a result which validates the IRS' intransigent

refusal to give taxpayers the benefit of netting as Congress intended. This result frustrates the will of Congress, creates gross injury to taxpayers, and, in the end, damages the government itself by breeding disrespect for the administration of the tax laws. The importance of the question, and the issues necessarily raised in resolving it, merit certiorari.

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Respectfully submitted,

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